United Nations TD/B/C.I/29

United Nations Conference on Trade and Development

Distr.: General
8 April 2013

Original: English

Trade and Development Board
Trade and Development Commission
Fifth session
Geneva, 17–21 June 2013
Item 4 of the provisional agenda

The impact of trade on employment and poverty reduction

Note by the UNCTAD secretariat

Executive summary

Integration into the world economy and trade is essential for development, employment creation and poverty alleviation. However, the link between them is complex. Success stories of export growth and poverty reduction are not simple stories of trade liberalization but rather more complex ones. Most evidence suggests that merchandise trade liberalization does not impact the aggregate level of employment but does impact employment and wages at the sectoral and occupational level, thereby contributing to increasing inequality within countries. Services have emerged as the largest segment of the economy and employment, and increasingly account for a greater share of value added in merchandise exports. Efficient and productive services are important for economy-wide growth and indispensable for competitiveness in agriculture and manufactures. Nevertheless, little is known about the link between trade in services and employment. Increased tradability of services activities provides employment opportunities, including for women. Enhancing trade and employment linkage in services requires a comprehensive, integrated and coherent strategy at the national level, including development of regulatory and institutional frameworks, human skills and infrastructures. International cooperation is necessary to increase beneficial participation of developing countries in trade in services, so as to create greater pro-development impact, employment and poverty reduction.

Introduction

1. Trade plays a prominent role in job creation and poverty alleviation. Policies aim at enhancing countries' competitiveness and increasing exports, including by breaking into global value chains (GVCs) to generate employment or to replace imports and reshore production so that jobs return. Trade has also been considered as having a bearing on decreasing inequality between countries but also increasing inequality within countries.

2. In agriculture, the share of traded products to world production and specialization in production are increasing. Agricultural trade is an opportunity for many developing countries as the sector absorbs almost half the workforce, though poor working conditions are prevalent. Countries and organizations have refocused attention on agriculture to promote food security, employment creation and structural transformation. A recent International Labour Organization (ILO)/UNCTAD publication assesses the link between trade in agriculture and employment.

3. Much of the research and policy discussion has focused on the manufacturing sector. For decades, industrial work has been spread across the world. While in 1980 over half of industrial employment was in developed countries, in 2010 two-thirds was in the developing world.

4. In services, more jobs have been created in recent years than in any other sector. The emergence of "trade in tasks" through GVCs has offered an opportunity for developing countries to generate highly productive jobs, including for women. Services trade emerged later on the international policy agenda and knowledge about its effects on employment is insufficient. This note assesses the link between trade and employment with a focus on the services sector. It aims to identify policies that are supportive for job creation in services in developing countries.

I. Employment, inequality and poverty: A fragmented world

5. Creation of productive employment and distribution of income are essential for achieving poverty reduction and sustainable and inclusive development. Addressing inequality and employment has become increasingly important.

6. Income inequality among countries has been decreasing, although at a slow pace. Incomes are still very unequal, with an average gross domestic product (GDP) per capita of $160 in the 10 poorest countries compared to $50,180 in the richest, but the difference is decreasing. The share in global income of the highest two quintiles decreased from 95.3 per cent to 90.6 per cent, while that of the remaining three quintiles increased from 4.7 per cent to 9.4 per cent between 1990 and 2007.[1] Mainly middle-income countries saw gains as wages grew significantly.

7. However, income inequality within countries increased in recent decades. In most developed countries, inequality has grown dramatically since the 1980s. For example, the share of total income going to the top 10 per cent earners increased from 35 per cent in 1980 to about 50 per cent in 2007 in the United States of America.[2] Inequality is increasing

[1] Solt F (2009). Standardizing the world income inequality database. *Social Science Quarterly*. 90(2):231–242.

[2] Atkinson A, Piketty T and Saez E (2011). Top incomes in the long run of history. *Journal of Economic Literature*. 49(1):3–71.

in a majority of Asian and Eastern European countries (e.g., India, China and the Russian Federation). In Latin America and the Caribbean and Africa, the situation is mixed with some countries experiencing rising inequality (e.g. South Africa) and others seeing declining inequality (e.g. Argentina, Brazil) (Solt, 2009). Rising inequality within countries is a widespread trend.

8. An increasing skill premium is an important facet of this trend. Wages for high-skilled workers have grown in many countries more than those of low-skilled workers. Skill-biased technological change is the major explanation. Information technology complements highly educated workers engaged in abstract tasks, substitutes for moderately educated workers performing routine tasks, and has less impact on low-skilled workers performing manual tasks.

9. Recent increases in inequality are also due to rising unemployment. While the wages of those staying in their job often remain relatively stable, the number of unemployed has been increasing since the recent crisis. Global unemployment increased from 5.5 per cent in 2007 to 6 per cent in 2011, and in developed countries, from 5.8 per cent to 8.5 per cent.3

10. Similar to the decreasing share of low-wage earners in the total national wage bill, labour's share of national income has decreased. Between 1999 and 2011, average labour productivity in developed economies increased more than twice as much as average wages. Even in China, where wages tripled during the last decade, GDP growth was higher than growth of the total wage bill (ILO, 2012a). The declining labour share of national income is a global phenomenon. The trend has continued even after the post-crisis output and trade recovery. With stagnant and increasing unemployment, it fuels concern over jobless growth and rising discontent over social inequality.

11. Wage and skill differentials in services, covering a wide range of activities, appear to be generally higher than in agriculture or industry. In retail trade in developing countries, a small proportion of employees are professional, managerial or clerical workers. In Indonesia, for example, 80 per cent of workers in retail trade were informal. The picture is similar in construction, hotels and restaurants, and road transport, including with regard to below-average education. Business services provide above-average wages and the share of those employed having tertiary grades is high.

II. The impact of trade on employment and poverty: A complex relationship

A. Channels through which trade, employment and poverty are linked

1. Trade, growth and productivity

12. Several channels link trade and employment. With respect to the relationship between trade and growth, if trade openness has a positive effect on growth, this can lead to increased employment as more goods and services are produced. Several studies have found a positive correlation between trade and growth. Others find no correlation between trade openness and growth. Countries can be locked into an established pattern of production that – even if efficient use of a country's resource endowments is made – may not generate dynamic productivity gains that drive growth.

[3] ILO (2012a). *Global Wage Report 2012/13: Wages and Equitable Growth*. Geneva.

13. Recent discussion appears to assume a positive impact of trade on growth and focuses on inclusiveness and sustainability, especially the effect of trade on employment, including the possibility of jobless growth. Many African countries, for example, have experienced fast growth recently thanks to a commodity boom, but have created little employment.

14. The trade-growth-employment nexus is strongly linked to productivity growth. Productivity growth is particularly important for developing countries, inducing higher wages and better living conditions. Trade increases productivity, which enhances a country's competitiveness, leading to higher production, exports and employment. However, labour productivity growth also implies that less labour is needed to produce the same output. Thus, the employment-enhancing competitiveness effect has to be compared with the labour-saving effect.

15. Trade has a positive effect on productivity when new technologies are imported and spill over effects from foreign direct investment occur. Furthermore, participation of firms in trade increases the average productivity of a country, since more productive firms expand and less productive ones shrink due to greater export opportunities and import competition. This implies that even within sectors, some firms expand while others shrink.

2. Location of production and skill premium

16. Traditional trade models do not address directly trade's effect on the overall level of employment in an economy but provide insights into the relative demand for skilled and unskilled labour. In developing countries where unskilled labour is abundant, the demand for unskilled workers increases with rising trade, since exports of goods that use this factor more intensively increase while imports of products that use skilled labour more intensively increase. Developing countries specialize in the production of (unskilled) labour-intensive goods such as light manufacturing and, consequently, create jobs for unskilled workers. Thus, the relative demand increases for skilled labour in developed countries and for unskilled labour in developing countries. In developed countries, trade has in fact been found to have contributed to the rising skill premium.

17. The skill premium has, however, risen in many developing countries with some exceptions. Gaining ground in the South may have caused production of the least skill-intensive Northern goods to migrate to the South where they have become skill-intensive Southern goods. This might explain the increasing skill premium in developing countries.

18. Decreasing unit production costs have given rise to the emergence of large enterprises and industrial specialization. Falling trade costs can have opposing effects. The dependence on high-quality, cost-competitive inputs, including labour, can lead to agglomerations as is the case with "factory Asia" and the regionalized intermediates trade. Production can also decentralize, with the potential to encompass countries currently not integrated in GVCs.

3. Fragmentation of production, trade in tasks and offshoring

19. Trade liberalization and technological progress, especially in information and communication technology (ICT), have contributed to fragmentation of the production process, including through outsourcing and offshoring. Cost minimization strategies resulted in production using intermediate inputs originating from several countries. Trade in intermediate goods and services increased significantly and GVCs became dominant in some sectors.

20. The wage differential between developed and developing countries supported the relocation of some production processes (e.g. textile and electronics) from developed to developing countries with corresponding sectoral employment gains for the latter. The

increased mobility of production has, however, also created concerns over a "race to the bottom" regarding wages and working conditions. While some see GVCs as a development opportunity, as countries do not have to develop capabilities to produce a sophisticated final product but only need to be internationally competitive in the production of some components, others underline risks of countries being locked into low value added processes and facing difficulties in creating jobs in more dynamic sectors. Due to the high level of specialization, the entry barrier for newcomers is very high. Nevertheless, many countries, mostly in East and South-East Asia, have benefited from this development and several have also moved up the value added ladder.

21. It is known that companies gain access to advanced technologies not only through imports but also increasingly through outsourcing and offshoring. Offshoring – procurement of material inputs or services by a firm from outside the host country – and its impact on employment have been the focus of recent research efforts. Two effects dominate in developed countries: (a) the direct negative effect of relocating jobs abroad ("relocation effect") and (b) a potential positive effect arising from higher sales due to increased productivity of a company ("scale effect"). Indirect effects occur if (c) a company offers its goods and services at lower prices to other firms (as they may then be able to expand their activities) and (d) if prices for consumers decrease (as this allows consumers to spend their income on other goods and services, raising employment in other sectors).

22. Increasingly, certain tasks are outsourced and offshored. Some developing countries have become competitive suppliers of tradable services (e.g. India in information-technology (IT) services).

B. Trade and employment: empirical evidence

23. The link between trade and employment is complex. Trade liberalization and expansion is often accompanied by broader reforms and other macroeconomic changes, which make it difficult to disentangle the effect of trade on employment empirically. However, many studies have assessed this link with the majority focusing on industrial goods. Fewer studies have analysed services trade.

24. Empirical studies suggest that the degree of trade openness is not an important determinant of either overall employment or aggregate unemployment. No correlation was found between trade liberalization and industrial employment over the period 1980 through 2006 in a data set including many developing countries,[4] and between change in the employment–population ratio and in trade openness between 1995 and 2005.[5] In general, in the longer run, the impact of imports on employment is more positive than in the short run. Hoekman and Winters[6] conclude that "the direct effects of trade reform on aggregate employment are muted". An important reason is that displaced workers from import-competing activities are not easily absorbed by exporting sectors.

25. Evidence suggests that the impact of trade liberalization on labour markets operates more through wages than employment. Labour market characteristics determine the relative importance of the two channels. More adjustment occurs through wages in flexible labour

[4] McMillan M and Verduzco I (2011). New evidence on trade and employment: An overview. In: Jansen M, Peters, R and Salazar-Xirinachs JM eds. *Trade and Employment, From Myths to Facts*. ILO, Geneva: 23–60.

[5] Organization for Economic Cooperation and Development (OECD) (2007). *OECD Employment Outlook 2007*. Paris.

[6] Hoekman B and Winters A (2005). Trade and employment: Stylized facts and research findings. Policy Research Working Paper 3676. World Bank.

markets. Greater adjustment through wages appears to be happening also in developing countries. Trade liberalization decreased industry wage premiums in those sectors that experienced the largest tariff reductions.

26. Trade liberalization of a country's own market is not a necessary condition for integration into the world economy at the outset. The economic integration of developing countries, including through export-led growth strategies, appears to have had great potential for job creation. Successful integration was part of every development success story of past decades. Evidence shows that some countries have been very successful in creating a significant number of productive jobs in expanding exporting sectors. Opening a country's own market is not sufficient and, it has been argued, may be even counterproductive. Many early industrializers had high trade barriers during their early development stages. Thus, many jobs newly created in South-East Asia, for example, can be attributed to trade, but not to trade liberalization of their markets. Measures to complement integration into global markets, such as education and export promotion, have been important.

27. This view does not contradict the fact that wealthier countries have more open markets. Once an economy has reached a certain level of development, access to high-quality inputs and technologically advanced capital goods is required to maintain competitiveness and innovation. Trade liberalization has a positive impact on export diversification in middle-income countries but this effect almost disappears in low-income countries.

28. Assessments of offshoring's effects on employment and wages in the home country, mostly in the manufacturing sector in developed countries, reveal relatively small effects. A negative relocation effect is often offset by a positive scale effect. Low-skilled workers are more likely to lose and high-skilled workers, to gain. The direction of outsourcing may matter as well. Offshoring to high-wage countries is positively correlated with manufacturing employment in the United States, and offshoring to low-wage countries, with declining employment. Most pressure from offshoring operates through wages. Displaced low-skilled workers, for example, take up lower-paid jobs in the services sector. Offshoring therefore appears to contribute to the increased skill premium in developed countries.

29. For developing countries, attention has been given to manufacturing inshoring, i.e. being the host for offshored activities, as this is seen to expand employment and promote development. Employment effects are positive but linkages to domestic industry are sometimes weak, and high productivity may lead to less job creation relative to outputs. Offshoring has also created jobs in services in developing countries.

Trade and inequality and poverty

30. Evidence confirms that trade is among those factors contributing to the increase in the relative reward for skilled labour. In developed countries, low-skill jobs have been offshored or replaced by imports from countries with lower wages, putting further pressure on low-skill wages. Trade liberalization also led to a rise in the skill premium in Latin America while during periods of expanding trade, this link was not confirmed for Asia. Thus, most evidence suggests that, with some regional variations, trade contributed to increasing inequality in the remuneration of skilled and unskilled labour in many countries.

31. Increased inequality does not imply that the least favoured segments of the population are worse off in absolute terms. The link between trade, poverty and growth is controversial. Developing countries that adopted export-led growth strategies, such as the "Asian tigers", are used as examples of trade's positive impact on development and poverty reduction. However, some studies show no significant positive correlation between trade

openness and growth. One argument is that trade openness and export orientation are separate issues and that most countries protect and develop their own industries before opening up their markets. The failure by some countries, notably least developed countries (LDCs), to diversify and undergo structural transformation has led to slow growth and persistent poverty. A large body of empirical work, reviewed by Winters et al.,[7] finds that trade liberalization reduces poverty on average and in the long run. In another review, Santos-Paulino[8] concludes that "trade liberalization improves aggregate welfare but the gains are small and unequally distributed". Benefits from trade are not equally distributed and losers typically, not compensated.

32. Most knowledge about the link between trade and employment results from the manufacturing sector. Much less is known about the link between trade in services and employment despite its increasing importance.

III. Services, trade and employment: A rising sector

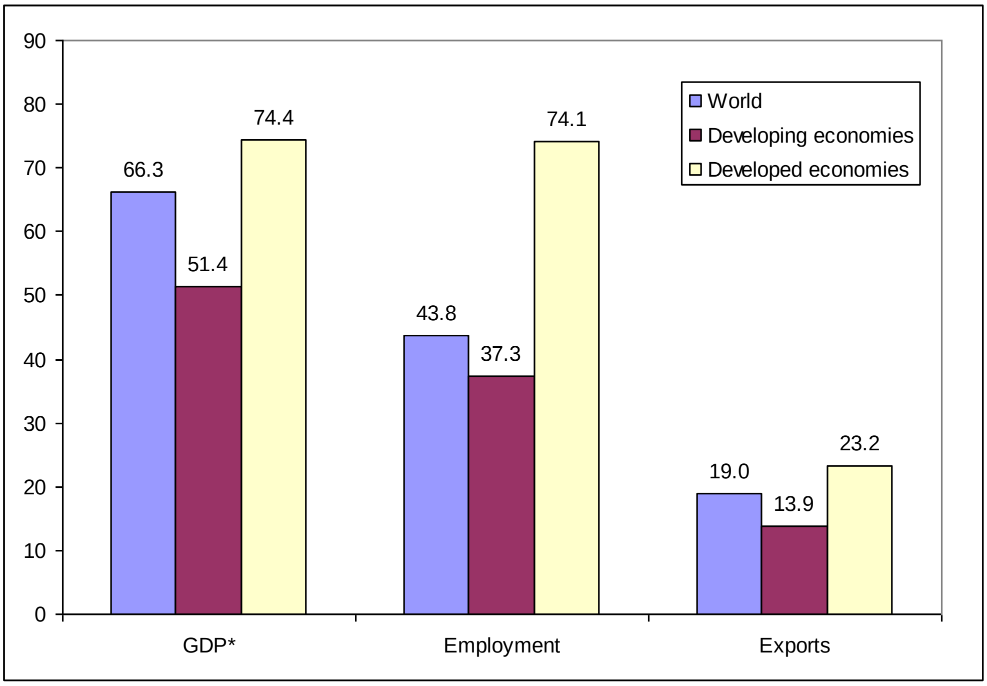
33. The services sector has become the main economic activity and source of employment in the world economy. It accounts for two-thirds of world output and 44 per cent of world employment (figure 1). Services represent a significantly larger share in developed economies than in developing countries where the sector represents 74 per cent of GDP and of employment. In developing countries, services account for less than half of GDP with the exception of Latin America and the Caribbean (62 per cent). The services sector's contribution to GDP increased in developed countries during the last 20 years. In many developing countries, the initial upward trend of the sector's GDP share stagnated in the 1990s–2000s.

34. Services account for a high share of labour productivity growth. The development of services, particularly infrastructure and IT services, contributes significantly to economy-wide productivity growth as services provide indispensable inputs to other products and services.

[7] Winters LA, McCullock N and McKay A (2004). Trade liberalization and poverty: The evidence so far. *Journal of Economic Literature*. 42:72–115.

[8] Santos-Paulino AU (2012). Trade, income distribution and poverty in developing countries: A survey. UNCTAD Discussion Papers No. 207.

Figure 1
Share of services sector in GDP, employment and total exports, 2011
(Percentage)

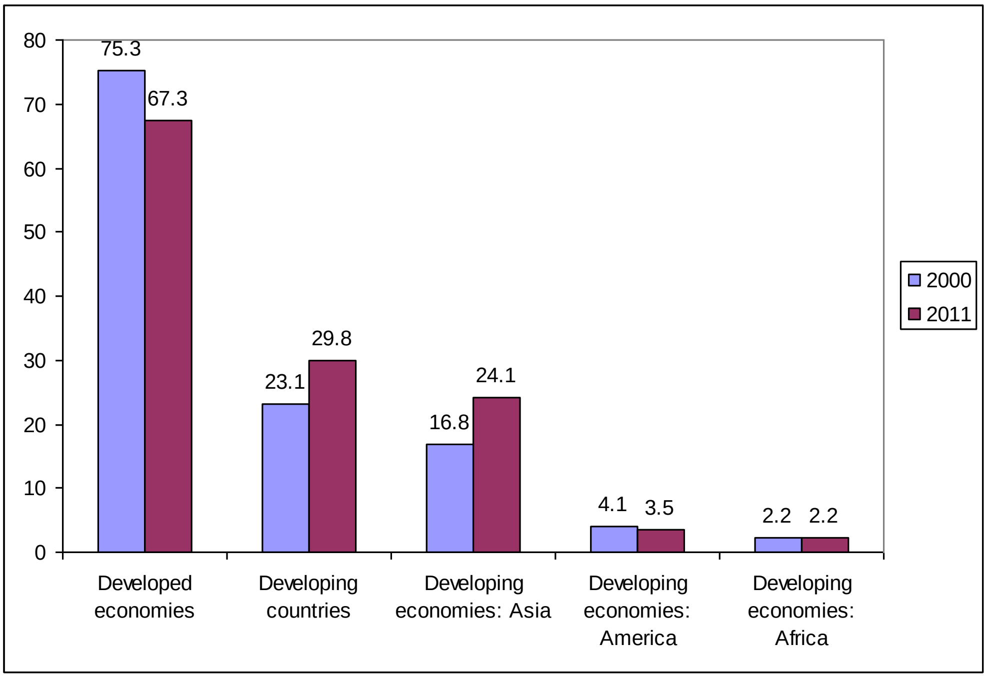


Sources: UNCTADStat database; ILO (2012b), *Global Employment Trends 2012: Preventing a deeper jobs crisis*, Geneva.
* Data for GDP are for 2010.

35. Global services trade stood at $4.2 trillion in 2011 and represented 19 per cent of world exports in goods and services. For developing countries, the share is 14 per cent. However, services exports have registered robust growth. Between 2000 and 2011, global services exports grew 11 per cent annually, faster than merchandise exports.

36. Services exports have become an important source of external revenues for some developing countries. Developing countries registered 13.9 per cent annual export growth, faster than in developed countries (9.8 per cent), with particularly strong growth registered in Asia (15 per cent). Consequently, the share of developing countries in world services exports increased from 23 per cent in 2000 to 30 per cent in 2011 (figure 2). Developing countries were, however, more successful in expanding merchandise exports, accounting for half of world exports.

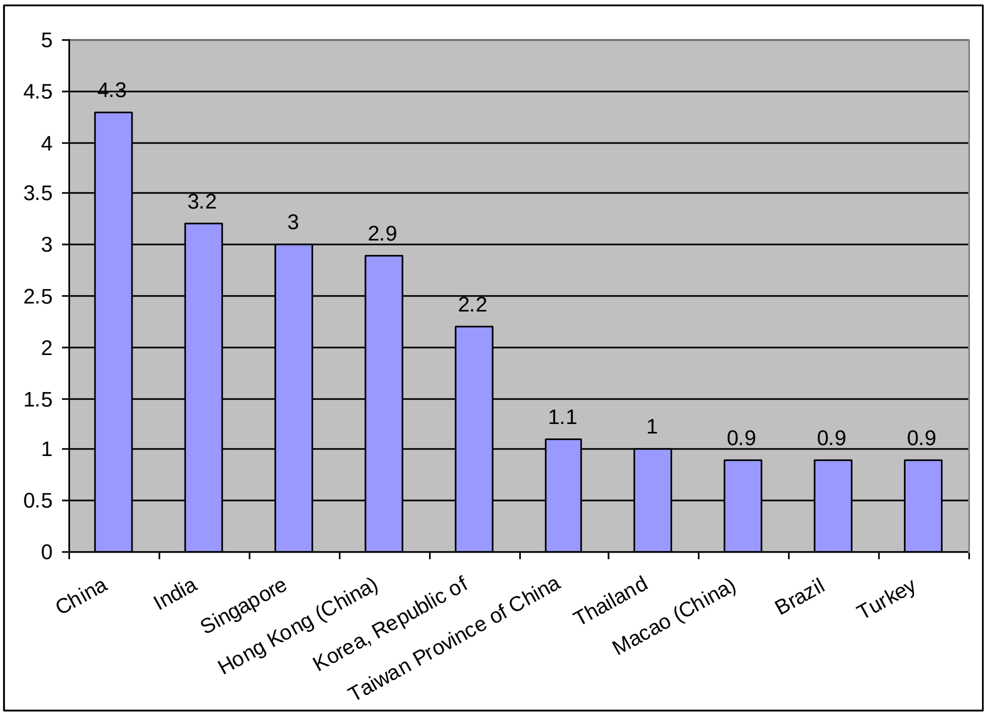
Figure 2
Share in world services exports, 2000 and 2011
(Percentage)



Source: UNCTADStat database.

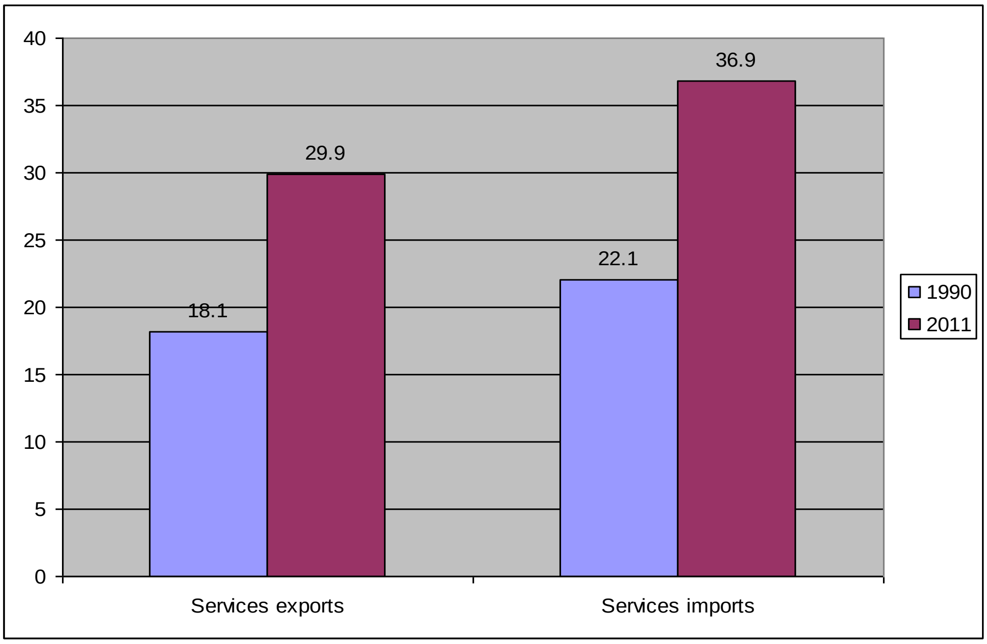
37. Few developing countries have managed to become a global supplier in services; China is the leading services exporter, followed by India, Singapore and Hong Kong, China (figure 3). The largest developing country exporters account for 70 per cent of total developing country services exports in 2011. The level of concentration has increased over time as these top developing country exporters used to account for just 58 per cent in 2000.

Figure 3
Top services exporting developing countries' share in world exports, 2011
(Percentage)



Source: UNCTADStat database.

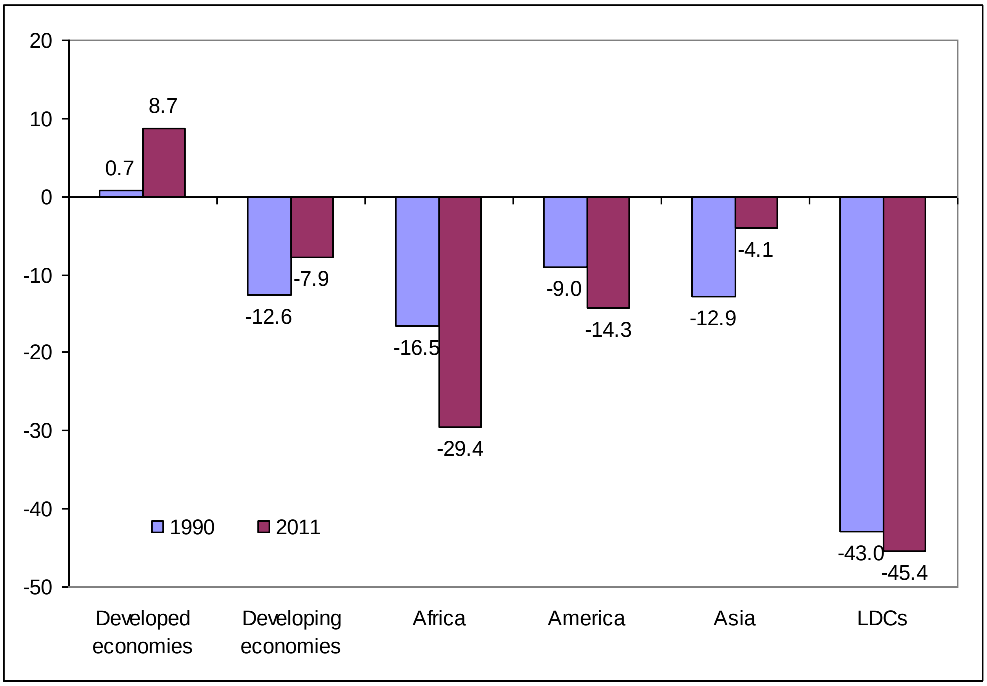
Figure 4
Developing countries' share in world services trade, 1990 and 2011
(Percentage)



Source: UNCTADStat database.

38. The share of developing countries in world services imports has increased to 37 per cent (figure 4). The fast increase in services imports has widened services trade deficits in many countries, especially in LDCs and Africa (figure 5). Asia is a major exception, with the services trade balance improving significantly in two decades. While developed countries recorded a growing surplus, in many developing countries the widening services trade deficit squeezes surpluses in goods trades. Together, developing countries registered a $218 billion deficit in services trade.

Figure 5
Services trade balance as a share of services trade volume, 1990 and 2011
(Percentage)



Source: UNCTADStat database.

A. Fragmentation of production and services

39. The past decade has witnessed increased fragmentation of industrial production, prompted by a more liberal trade environment and lower transport and communication costs. GVCs are prevalent in several industries, involving a growing number of developing countries.

40. Trade in intermediary goods has increased in all regions since 2002. Valued at over $7 trillion in 2011, it accounts for about 40 per cent of world trade. Half of East Asian exports of intermediary goods ($2 trillion) are intraregional. Other developing countries represent a much smaller, albeit increasing, share of world intermediary exports.

41. The share of services in intermediate trade in goods and services increased between 1995 and 2009 from 24 to 28 per cent, whereas the share of industrial goods supply-chain trade decreased from 61 to 52 per cent.[9]

[9] Baldwin R and Lopez-Gonzalez J (2012). Supply-chain trade: A portrait of global patterns.

42. The fragmentation of production and technological progress has also led to a "servicification" of manufacturing which contributed to higher trade in services. Production in different locations requires higher transport and logistics inputs. IT and business services are increasingly outsourced and the relative importance of services such as research and marketing in the production process has increased.

43. Taking into account the direct and indirect value added content of gross exports, the share of services in total goods and services exports increases to 46 per cent (table 1). Much of the services trade is invisible since it appears as trade in goods. For example, to produce a car, IT and transport services are used and indirectly traded when the car crosses borders. The content of services in gross exports is 50 per cent in developed countries, significantly higher than in developing countries. Manufacturing exports include 34 per cent services in developed countries and 26 per cent in developing countries. In agriculture shares are lower.

Table 1
Services value added embodied in gross exports
(Percentage)

	All countries	*Developed countries*	*Developing countries*
Total (including services)	46	50	38
Agriculture	23	28	15
Manufacturing	31	34	26

Source: UNCTAD, based on World Trade Organization (WTO)-OECD Trade in Value Added (TiVA) database.

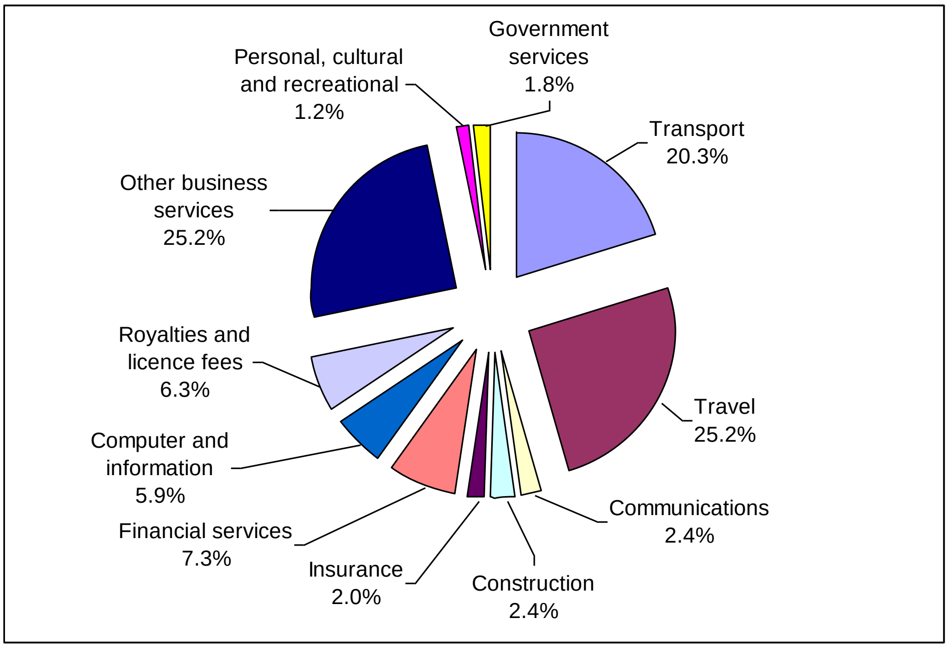
44. The high share of services content in exports of goods and services demonstrates the importance of efficient services sectors, both domestic and foreign. The foreign services value added embodied in gross exports is about 11 per cent. In developed countries, 39 per cent of services value added is produced domestically and in developing countries, 27 per cent.

B. Services trade at the sectoral level

45. Travel, transportation and other business services are the three major services categories (figure 6). These sectors constitute over 70 per cent of global services exports. Other business services include diverse activities, including legal, advertising, consulting, accounting and research and development. Together with computer and information services, other business services are emerging as the fastest growing activities. Developing countries registered a particularly high and increasing market share in construction and travel services (40 per cent), as well as in computer and information services (30 per cent) largely driven by India (figure 7).

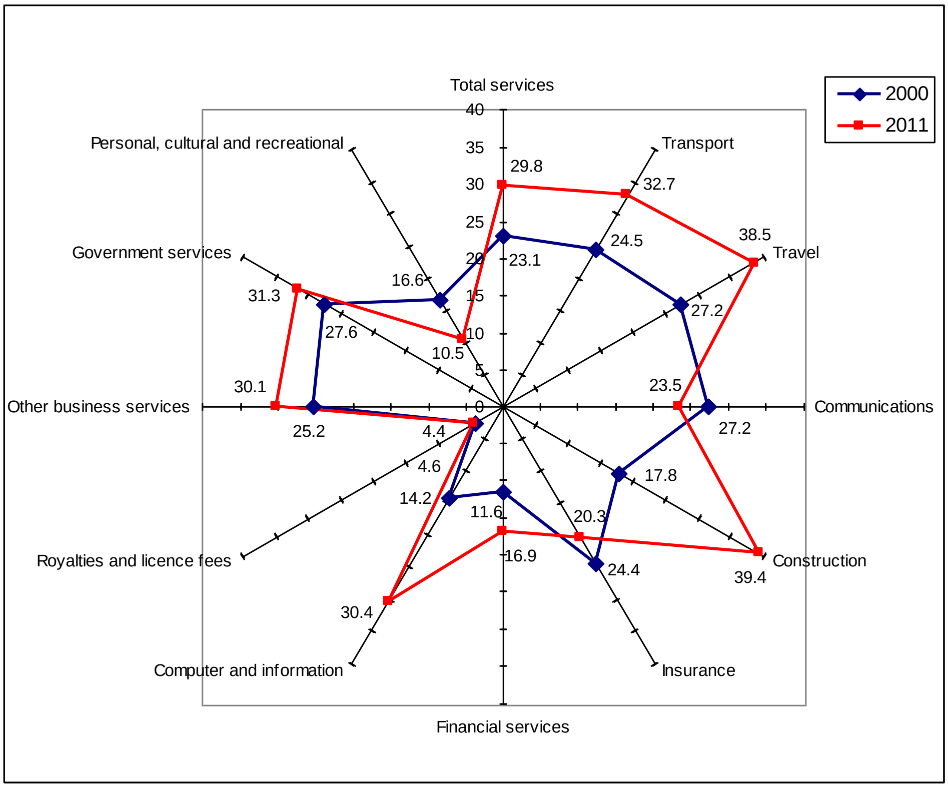
December. Available at http://www.econ.hit-u.ac.jp/~cces/COE2012_HP/paper/richard_baldwin.pdf.

Figure 6
World services exports by categories, 2011



Source: UNCTADStat database.

Figure 7
Share of developing countries in world services exports, 2000 and 2011
(Percentage)



Source: UNCTADStat database.

C. Services becoming the main sector of employment

46. The services sector is becoming the major sector of employment (table 2). During the last decade, the share of services in total employment climbed to 44 per cent. In developed countries, the sector now represents three-quarters of employment. Fast-growing services exports contributed to job creation. In developing countries, the services sector's share is low at 37 per cent but increased at the expense of agriculture. The industry sector's increased share in developing countries reflects vibrant industrial exports including in GVCs and domestic investment. In all regions except North Africa, the share of services employment increased during the last decade. The sector is particularly important in Latin America and the Caribbean. In Asia and sub-Saharan Africa, agriculture still captures a significant share.

Table 2
Distribution of employment by sector
(Percentage)

	2000			*2011*		
	Agriculture	*Industry*	*Services*	*Agriculture*	*Industry*	*Services*
World	40.5	20.4	39.1	34.1	22.1	43.8
Developed economies	5.5	27.3	67.3	3.8	22.1	74.1
Transition economies	25.8	24.7	49.6	20.0	26.3	53.8
Developing economies	49.3	18.6	32.2	40.9	21.8	37.3
East Asia	47.6	23.4	29.0	35.4	28.2	36.4
South-East Asia and the Pacific	49.7	16.4	33.9	43.1	18.4	38.5
South Asia	59.5	15.6	24.9	51.0	21.0	28.1
Latin America and the Caribbean	20.5	21.6	57.9	16.0	22.0	62.0
Middle East	22.4	24.3	53.3	16.7	25.6	57.6
North Africa	30.5	19.4	50.1	28.5	21.9	49.7
Sub-Saharan Africa	66.3	7.9	25.9	62.0	8.5	29.5

Source: ILO (2012b).

47. Services have also become the largest provider of jobs to women. The sector absorbed 48 per cent of women in the workforce in 2011, as compared to 41 per cent in 2000. In 2000, agriculture was the main employer of women but its share declined to 35 per cent in 2011. The industrial sector employs 17 per cent of women in 2011. Regional data show significant variation. The services sector was the main employer of women in developed countries (63.6 per cent), Latin America and the Caribbean (78.2 per cent), the Middle East (59.4 per cent) and North Africa (52.5 per cent). Agriculture remained the most important sector in sub-Saharan Africa and South Asia (62.6 and 68.6 per cent respectively, in 2011).[10] In many developing countries, the more traditional, non-tradable, low-productivity services with reduced capital accumulation potential, such as small retail trade, restaurants, and personal services, have accounted for the increasing share in employment of women.

[10] ILO (2013). *Global Employment Trends 2013: Recovering from a second jobs dip*. Geneva.

48. Several factors contribute to the increasing share of services in employment. These factors are technological changes that increase demand for labour in services; outsourcing of services-related activities from manufacturing to specialized services firms; the growing role of services as providers of intermediate inputs; a disproportionate increase in consumer demand for services as a result of rise in per capita income; demographic developments; the provision of certain services as public goods; and low productivity growth in services. Of these, the real shift in final demand towards services, the role of income growth and productivity changes have been identified as major drivers. The lower mechanization of many services makes services more expensive relative to agriculture and industry, and thus increases their share in GDP. Services therefore continue to exhibit a strong labour demand, while employment in agriculture and industry is declining.

49. Informality is common in most countries but more extensive in developing countries. The incidence of informal employment is greatest in services sectors such as construction. In some countries, the share of informal employment is above 90 per cent of total sectoral employment. The participation of women is also disproportionately high. The informal economy does not only represent the inferior segment of a dual labour market. There is significant evidence that informality, at least in part, is driven by dynamic, small-scale entrepreneurial activity and strategic behaviour.

D. Services in the international trading system

50. Services became an integral part of the multilateral trading system with the establishment of WTO in 1995 as a result of the Uruguay Round. The extent of liberalization achieved under the General Agreement on Trade in Services (GATS) has been limited as many countries opted for a bound level of protection that is higher than the currently applied level.

51. The Doha Round on services was intended to liberalize trade and achieve increasing participation of developing countries in trade in services. Given asymmetries in competitive export capacities, lack of progress in agriculture and non-agricultural market access and attempts to modify the negotiation approach hampered negotiations. Developing countries were concerned over the lack of value added in areas of interest to them, i.e. cross-border trade (mode 1) and temporary movements of individual service suppliers (mode 4). Liberalization of mode 4 has often been limited to highly qualified professionals while developing countries have sought openings for lower-skilled workers. The gains for developing countries in mode 1, where expansion of ICT allows for increasing trade, could be significant as outsourcing is often associated with foreign direct investment (FDI), human capital formation and knowledge spillover. Measures requiring commercial presence for suppliers to deliver cross-border services or outright prohibition of outsourcing have acted as barriers.

52. Current restrictions indicate sensitivities of services. Concerns have been expressed over the possible effects of services trade liberalization, inter alia, on (a) access to essential services, especially for least favoured segments of the population; (b) national non-economic policy objectives such as education, health and culture; (c) competitiveness of domestic industries, including employment effects; (d) regulatory frameworks; and (e) short-term adjustment. These potential costs arise from import penetration, which can generate unemployment and underutilization of production factors in declining sectors.

53. Concerns also arise because some services are inherently monopolistic and therefore susceptible to exploitation of market power unless an appropriate regulatory system exists. Others, like audiovisual services, are of social or cultural significance. Yet others, such as retailing, may have greater social effect given the presence of large small-scale providers.

Air transport and finance are often considered strategically important and loss of national ownership, regarded as harmful to national interests.

54. Competitive services, however, are an important determinant of growth. Evidence suggests that strategic services liberalization is a potential source of gains in economic performance, including productivity in manufacturing.

55. While multilateral negotiations are in a stalemate, trade liberalization efforts take place at the regional level. While only five services regional trade agreements (RTAs) had been notified to WTO before 2000, 103 additional agreements have been notified since then. Although two-thirds of existing RTAs do not cover services, the majority of North–South RTAs do, and telecommunication and financial services figure prominently.

56. RTA commitments in both modes 1 and 3 generally go beyond commitments made under GATS. GATS-plus commitments in RTAs are more important for developing countries than for developed countries. Advances in RTAs occur differently across sectors. Some services sectors that already registered a high degree of openness under GATS (computer and telecommunication) continue to see further liberalization. Financial services exhibit a modest level of GATS-plus in RTAs. Transport services are subject to the lowest level of GATS commitments given the sector’s sensitivity but see the largest GATS-plus commitments under RTAs.

57. Regulatory reform and competition are the forces behind recent liberalization in trade in services. Trade liberalization in services essentially addresses “regulatory” measures, because whether, to what extent and how to allow international competition in domestic services market are essentially regulatory decisions. Regulatory harmonization and mutual recognition could remove barriers arising from diverse technical standards, particularly in transport, financial and related professional services. Such regulatory harmonization is more feasible in a regional context. South–South cooperation could be complementary, as it directly contributes to economies of scale and building productive capacities.

58. Various behind-the-border regulatory measures under existing North–South RTAs could have a potential “regulatory chill” effect because regulators may be discouraged from introducing and modifying regulations for public policy goals due to concern over potential conflict. Provisions on investor protection against indirect expropriation and judicial reviews of regulatory decisions (i.e. investor–State disputes) could have such effects.

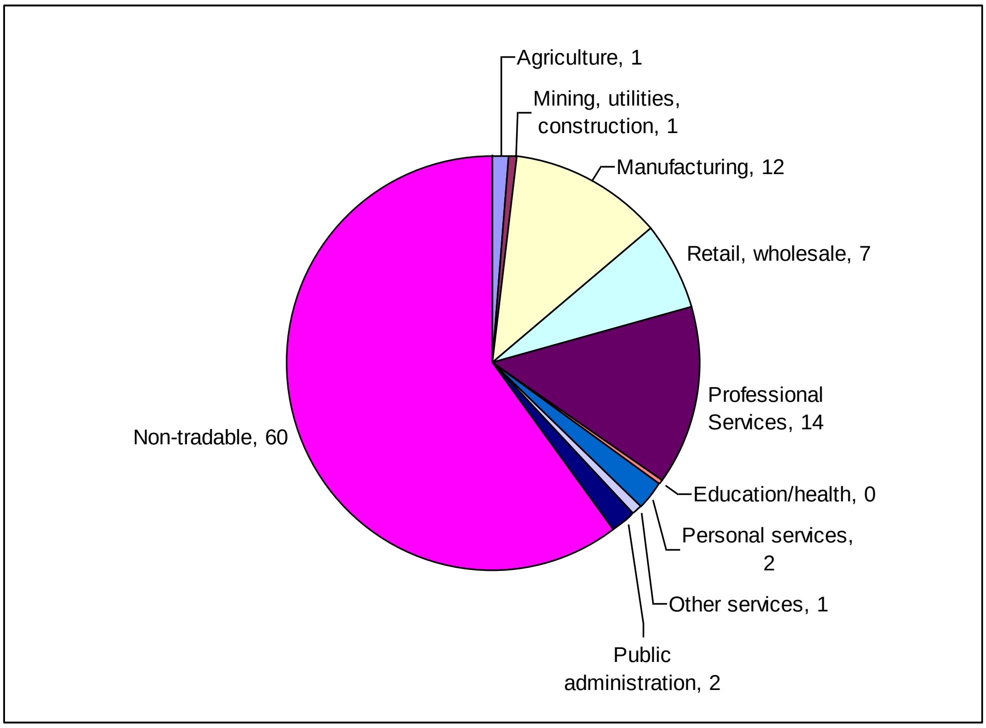
IV. Trade and employment linkages in services: High potential but challenging for many developing countries

59. The increasing importance of services in output, trade and employment, as opposed to scarce knowledge about their linkages, emphasizes the need for increased research in this area.

60. In high-income countries, growing concern exists that services offshoring will lead to domestic job losses, including high-wage jobs. The high share of employment in tradable services fuels this concern. A study on the United States found that 40 per cent of total employment in the country is in tradable industries (figure 8). Some large services sectors, e.g. health care and public administration, have a small share of employment in tradable industries. Nevertheless, since the overall services sector is larger than the manufacturing sector, a higher number of jobs in services sectors are potentially exposed to international trade. Furthermore, some intermediate input production in services in non-tradable industries (e.g. computer programming in banking) may be tradable even if the industry is

not. Tradable services jobs represent relatively more high-education and high-wage positions than non-tradable activities.

Figure 8
Tradable industries' share of employment
(Percentage)



Source: Jensen JB and Kletzer LG (2006). Tradable services: Understanding the scope and impact of services outsourcing. Working Paper No. 05-9. Institute for International Economics.

61. Research, based on the premise that tasks that can be offshored are often complementary to tasks that cannot, and thus cannot as easily be offshored as initially thought, found that between 20 and 29 per cent of all jobs in major economies could be potentially offshored.[11] A significant share of jobs in the services sector is tradable, contrary to the belief that services jobs are mostly non-tradable.

62. In the United States, evidence suggests negative impact of offshoring services on employment in manufacturing and services industries when employment in disaggregated industries is considered, but this effect disappears when industries are aggregated into broader sectors, indicating that workers who lose their job in one industry move to another growing industry. Similarly, for the United Kingdom of Great Britain and Northern Ireland, jobs displaced by services outsourcing are likely to be offset by new jobs.[12]

63. Distinguishing between different skill levels, evidence indicates that services offshoring changes the composition of employment in favour of high-skilled workers in developed countries as low skill-intensive services are offshored to developing countries.

[11] Lanz R., Miroudot S and Nordas H (2012). Trade in tasks. In: Lippoldt D (ed.). *Policy Priorities for International Trade and Jobs*. OECD. Paris: 237–248.

[12] Amiti M and Wei S-J (2009). Service offshoring, productivity and employment: Evidence from the United States. *The World Economy*. 32(2):203–220; Amiti M and Wei S-J (2005). Fear of services outsourcing: Is it justified?" *Economic Policy*. April: 308–347.

But educated high-skill workers can also face competition from educated, lower-paid high-skill services workers from developing countries. However, taking into account sales of services produced in developed countries to unaffiliated buyers in China and India, the net effect in developed countries is likely to be positive though small. Services offshoring appears to have had little effect on employment levels in developed countries. Negative relocation effects appear to have been mostly offset by indirect positive effects on workers in other sectors or with different skill levels.

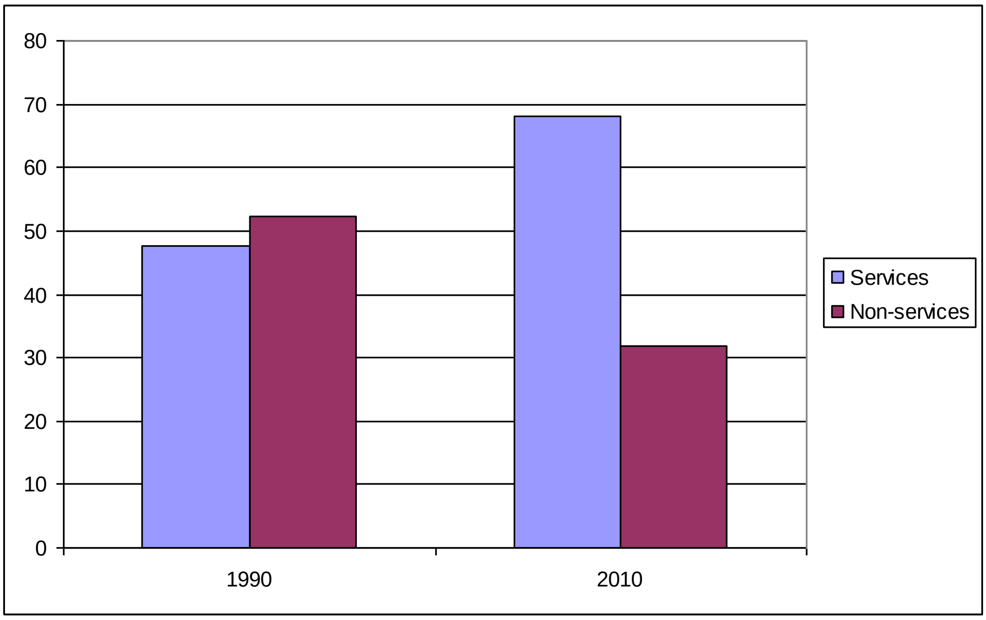
64. Offshoring is an opportunity for developing countries. In South Asia, growth in the services sector outpaced that of other sectors between 1995 and 2009. The main sectors with significant employment growth are construction, tourism, retail trade, health care and IT business process outsourcing. Employment creation has also been favourable compared to other sectors and regions since 2000, indicating that services growth contributed to services employment growth. However, employment growth in services was not commensurate with that of output growth as employment elasticity is relatively low in the region. UNCTAD research[13] also suggests that the link between trade growth and employment creation is relatively small in services compared to the agricultural and industrial sectors.

65. Employment generation from services FDI is also smaller than in other sectors. Data for Japan, Germany and the United States reveal that the share of outward stocks in services is higher than the corresponding employment share. However, FDI is still considered to generate employment in host countries and the job-creation effect is increasing with the rise of export-oriented services. Services FDI has increased disproportionately in recent decades (figure 9), representing a large share of services trade. FDI inflows into developing countries account for 37 per cent of world FDI inflows in services (2008–2010), an increase from 19 per cent in 1990–1992. Furthermore, indirect effects through high-quality services from multinational enterprises and resulting positive employment effects in upstream industries in host countries contribute to employment creation. Dee et al.[14] show that a 50 per cent liberalization of investment in services could create employment of up to 1.4 per cent in countries with restrictive sectors for skilled labour and 1.2 per cent for unskilled labour.

[13] UNCTAD (2013, forthcoming). Trade in services and employment. Geneva.

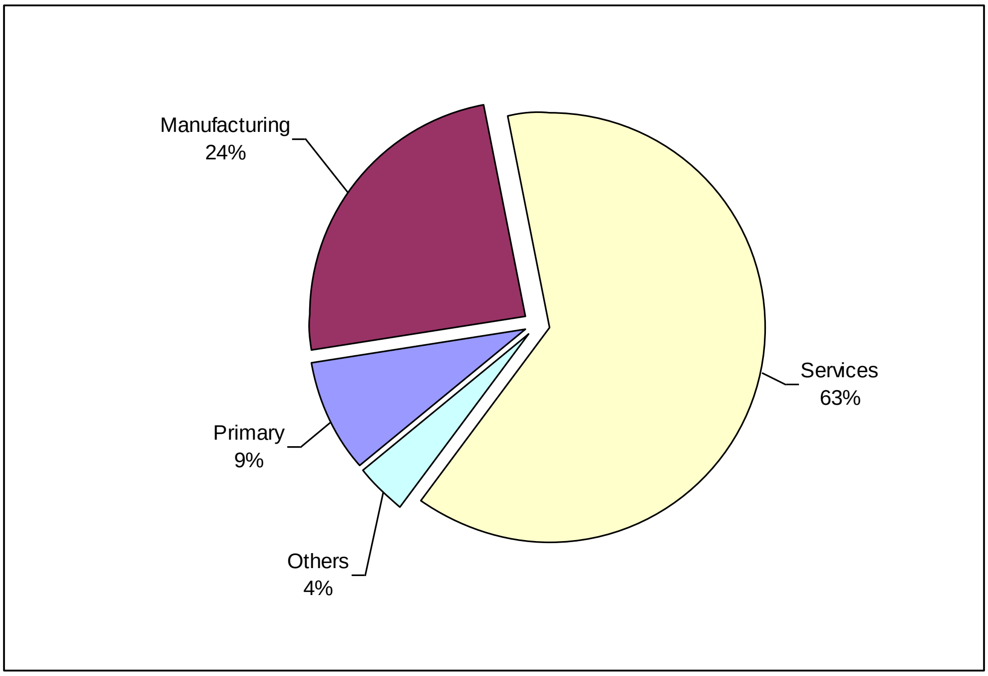
[14] Dee P, Francois J, Manchin M, Norberg H, Nordås HK and van Tongeren F (2011). The impact of trade liberalization on jobs and growth: Technical note. Trade Policy Working Papers No. 107. OECD.

Figure 9
Share of services FDI outward stock in 1990 and 2010
(Percentage)



Source: UNCTAD (2012). World Investment Report, database annex tables. See http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx (accessed 28 December 2012).

Figure 10
Distribution of world FDI inflows by sector, 2008–2010



Source: UNCTAD (2012). World Investment Report, database annex tables. See http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx (accessed 28 December 2012).

66. Evidence suggests that India is the greatest net beneficiary from offshoring. In 2007 IT-enabled services and business process offshoring accounted for 553,000 jobs and the software exporting sector employed another 270,000 people. Although these are high-paid jobs, the numbers are relatively small compared to the size of the increasing workforce in India. Concerns over high geographical concentration, small linkages to the rest of the economy and low innovation have been raised. Similarly, in Peru employment effects from exports in engineering, consulting, logistic and computer-related services are expected to be concentrated in Lima and on skilled workers, with limited indirect economy-wide benefits.

67. In Nicaragua, employment effects and indirect economy-wide positive effects have the potential to be significantly positive in telecommunications, financial, road transportation and tourism services. The business process outsourcing sector has been identified as a key sector for high-skilled jobs and exports in Uganda. Several developing countries have been successful in expanding services centres, including call centres.

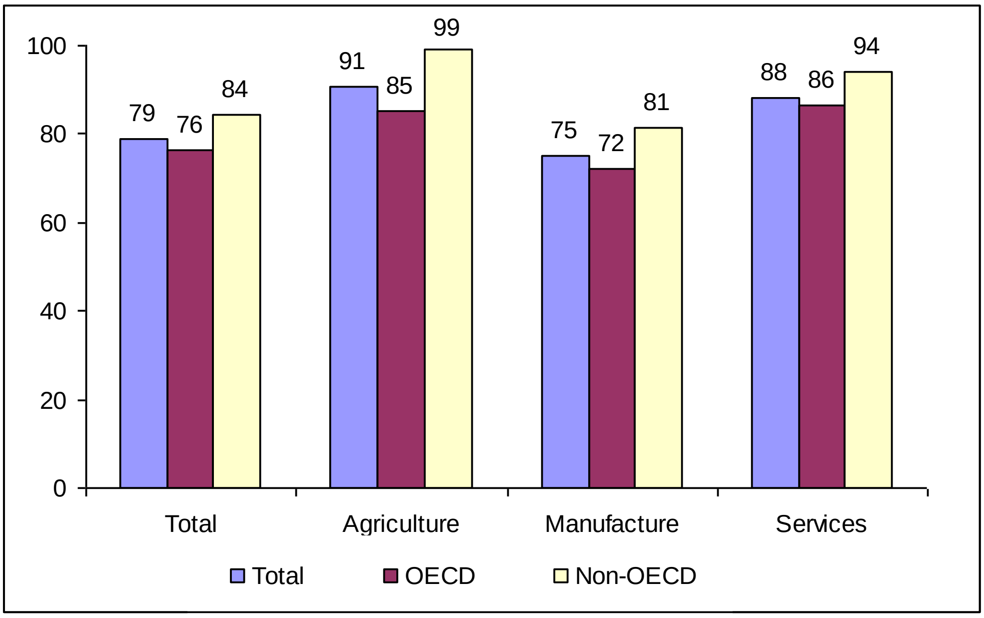
68. Potentially negative effects for employment and poverty could come from liberalization of the distribution sector. The distribution sector in Uganda, for instance, absorbed 10 per cent of the workforce, composed mainly of low-skilled workers. Liberalization could lead to crowding out small stores with potential for severe social impact.

69. Growing offshoring and the high tradability of services tasks and jobs create opportunities for developing countries to create productive employment. Services jobs are often better paid, and increasing productivity and efficiency in services sectors will have positive impact on employment in other sectors. Because of scale and indirect effects, there is little evidence to suggest that jobs created in developing countries would be lost in countries where companies offshore. However, challenges are manifold. Skill gaps, poor infrastructure and high entry barriers prevent many developing countries from benefiting from trade in services and offshoring. Requirements in education and language skills are high so that only a small proportion of young professionals are available for export-oriented services offshoring companies.

The link between value added trade and employment in services

70. Gross export figures do not represent value addition since many imported intermediate goods and services are used. Gross trade may therefore not be linked closely to employment.

Figure 11
Domestic value added share of gross exports (2009)
(Percentage)



Source: UNCTAD, based on WTO-OECD TiVA database.

71. The WTO-OECD TiVA database, which provides data on domestic value added content of exports, shows that the average domestic value added share of gross exports was 79 per cent in 2009 (figure 11); i.e. the remaining 21 per cent were imported intermediates. On average, developing countries add more value to their exports than developed countries. The latter are more deeply integrated into GVCs. Trade in GVCs is highly regionalized, with North America and Europe being major clusters. Furthermore, developed countries often produce more sophisticated products requiring more intermediate goods.

72. The domestic value added share is highest in agriculture and lowest in manufacturing. In services, 88 per cent of exports are domestic value addition, with a higher share in developing countries than in developed countries. High foreign input shares are observed in core manufacturing subsectors: electrical and optical equipment (33 per cent), transport equipment (30 per cent), machinery and equipment (24 per cent), other manufacturing and recycling (23 per cent), as their production and trade structures are relatively dominated by GVCs.

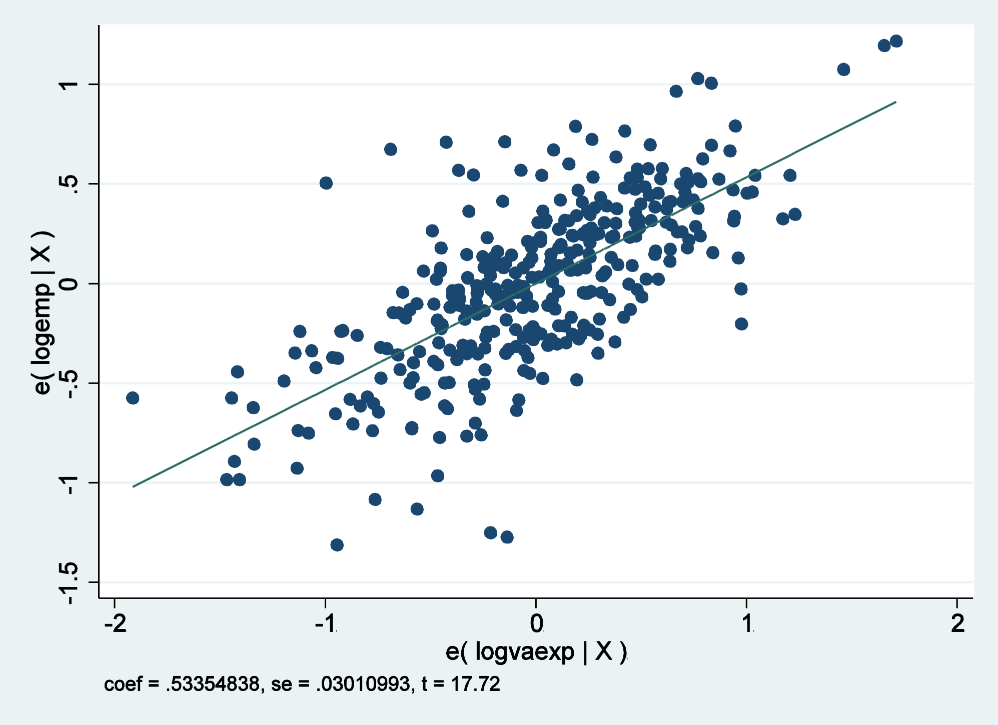
73. UNCTAD[15] analyses the link between gross trade and employment and value added exports and employment in different sectors in a paper that also assesses whether services exports have a lower job-creating effect than manufacturing.

74. The paper shows that employment and exports are positively correlated and employment is more responsive to changes in value added exports than in gross exports, though the difference is small. In core manufacturing, however, the difference is significant. One per cent higher value added exports is associated with 0.53 per cent higher employment in core manufacturing (figure 12). For gross exports elasticity is lower (0.47

[15] UNCTAD (2013, forthcoming). Employment data are from the World Input-Output Database (see http://www.wiod.org/).

per cent). Thus, in sectors that are more strongly linked to GVCs such as core manufacturing, changes in employment are more closely associated with changes in value added exports than with changes in gross exports, while in sectors that are less linked to global value chain trade there is no difference in association.

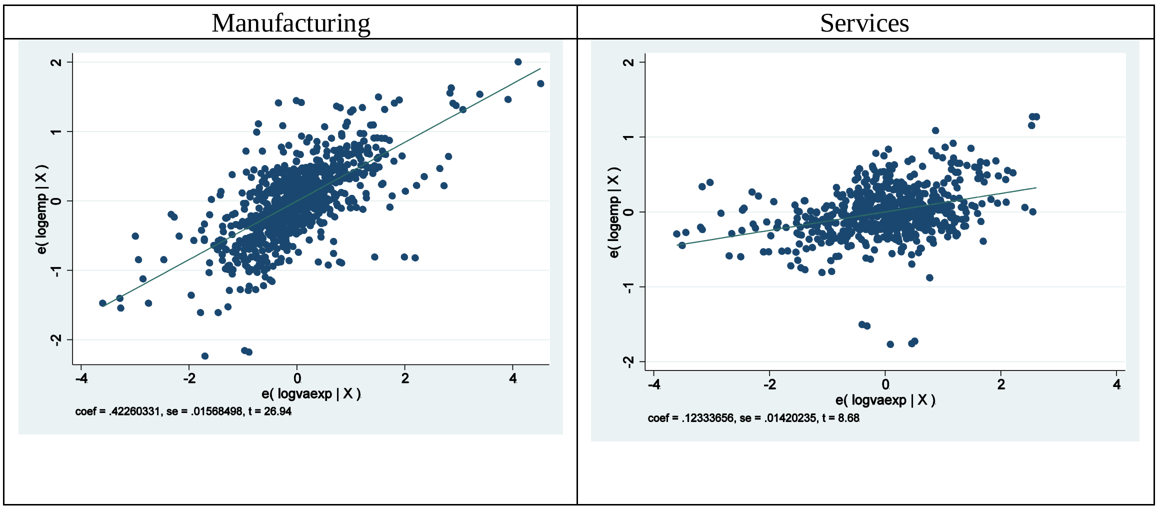
Figure 12
Employment and value added exports in core manufacturing



Source: UNCTAD calculation.

75. The nexus between employment and export performance varies significantly across sectors. A 1 per cent increase in value added exports in manufacturing is associated with a 0.42 per cent increase in manufacturing employment (figure 13). In services, the corresponding employment elasticity is only 0.12. This is likely due to a lower share of trade in services. Many services activities are not internationally traded and therefore services employment is more sensitive to domestic changes in demand than to export developments. Also, those services sectors that are mostly traded internationally could have disproportionate productivity gains when exports increase so that job creation remains limited. Correcting for the much smaller share of exports in services relative to services output and employment, it is possible that the absolute job creation effect of additional services exports is higher than in manufacturing. In Indonesia the job creation effect of additional fixed amounts of exports in many labour-intensive services sectors is higher than in most manufacturing sectors, and as high as in agriculture.

Figure 13
Employment and exports correlation for manufacturing and services



Source: UNCTAD calculation.

76. Analysis confirms that the link between gross trade and employment is weaker than between value added exports and employment, mainly in sectors that have the most segmented value chains. GVCs are important in a few sectors, including automobiles and electronic parts. Furthermore, though analysis confirms empirically that job creation in services is to a lesser extent linked to services exports than in manufacturing or agriculture, correcting for the smaller share of services trade in services output and employment, the link between services exports and employment may be as high or even higher than in manufacturing.

77. The results may have implications for development strategies. Increasing value addition is important for job creation. Export-led growth strategies in services create jobs and depending on the sectoral and geographical distribution could significantly contribute to alleviating poverty.

Trade and gender

78. Employment for women workers in developing countries increased in labour-intensive export-oriented industries. However, more equitable distribution of trade benefits can only be achieved if gender differences in employment are low with respect to sectors, occupations and skill levels.

79. Tourism, for example, represents an important opportunity for women's empowerment, as women constitute 60–70 per cent of the labour force in the tourism sector. Unlike other sectors, tourism can provide employment to women, including young women, with little formal training. However, there is a divergence between qualifications and employment opportunities for women. Unskilled or semi-skilled women tend to work in the most vulnerable jobs and on average are paid 25 per cent less than male workers for comparable skills.[16] A sufficient number of skilled personnel are preconditions for delivering high-quality tourist services. Women's participation in tourism education and training would allow them to have access to more qualified, stable and better-paid positions.

[16] ILO (2010). *Women in labour markets: Measuring progress and identifying challenges*. Geneva.

Informal employment

80. Under the conventional view, the informal economy expands countercyclically during downturns when workers are dismissed in the formal sector. Greater competition for domestic producers resulting from trade liberalization increases informal employment, as firms shed formal workers to cut costs. However, contrary to this view, a decrease in trade costs due to liberalization may lead informal firms to become formal as they expect higher gains in productivity from the shift. A comprehensive literature review concludes that estimates "point to the possibility that, over the near term, trade opening causes informal labour markets to grow, requiring protected companies in the formal sector to adjust and to reallocate jobs and workers". Over the longer term, benefits from more intensive trade could strengthen formal employment growth.[17]

81. The impact of trade liberalization on informal services sectors depends on the specific sector and the nature of the shock on the economy. If the overall shock is positive, informality may increase over the longer term as demand for non-traded services increases. Earnings in the informal sector could also be expected to improve relative to formal wages. If the overall shock is negative, then relative earnings would probably fall.

Green jobs and trade

82. Among the goals increasingly sought by policymakers is the support of a process of economic development and employment creation that is environmentally sustainable and socially inclusive. Services sectors are among those experiencing the most significant changes in a greening economy: energy, recycling, buildings and transport. The global drive towards a greener economy is already generating employment in these and manufacturing sectors. Labour studies indicate net gains on the order of 0.5–2 per cent.[18]

83. The distinguishing advantage of these new jobs is in their sectoral and geographical distribution; employment gains will be significant in poor rural areas in developing countries and in sectors easily accessible to poor rural workers. Opportunities are high in the agriculture sector and in green services sectors such as ecotourism, carbon sequestration and commercial services for small-scale off-grid renewable energy systems. Energy-based local content requirements are being considered in some countries, taking potentially higher costs of renewable energy into account in order to create jobs. The net employment effects are unclear as local content can also reduce employment when higher production costs lead to lower demand and competitiveness.

Temporary labour mobility

84. Mode 4 offers enormous potential for developing countries' participation in services trade but, until now, services that have been liberalized through mode 4 are mainly reserved for highly qualified professionals and senior business categories. Most potential service providers including women do not fall within these groups. It is often argued that mode 4 is unworkable, particularly for lower-skilled service providers, since countries of origin cannot guarantee the return of their service providers which thus becomes a migration issue. However, experience from some North–South RTAs shows that measures can be put in place to ensure that workers' stay abroad is temporary, including negative and positive incentives.

---

[17] ILO and WTO (2009). Globalization and informal jobs in developing countries. Bacchetta M, Ernst E and Bustamente J, eds. Geneva.

[18] ILO (2012c). *Working towards sustainable development: Opportunities for decent work and social inclusion in a green economy.* Geneva.

85. Lack of recognition of their professional and academic qualifications remains a major obstacle for developing country services providers. Bilateral or plurilateral mutual recognition agreements of academic and professional qualifications could address such obstacles. Professions of potential export interest to developing countries (e.g. health or social work) fall in most countries into the category of "accredited" or "regulated" professions where mutual recognition of qualifications is of particular relevance but developing country participation in mutual recognition agreements is limited. In order to increase benefits from services trade through mode 4, including for women, it is necessary to enhance multilateral dialogue and share good practices.

V. Conclusion: Supportive trade policies and complementary measures

86. The relationship between trade, employment and poverty reduction is complex as these are linked through several channels. Some developing countries have successfully created employment and reduced poverty by exposing their economy to global markets.

87. Services have emerged as major contributor to GDP, trade and employment, and account for growing value added content in world trade. Efficient and competitive services contribute significantly to economy-wide competitiveness and growth as services provide essential inputs to all economic activities including manufacturing.

88. Services trade provides opportunities to generate employment and reduce poverty. However, knowledge about the effect of services trade on employment is limited. Tradability of services is increasing. Several developing countries have seized substantial benefits by exploiting emerging areas of their comparative advantage, including modern exportable business services, although many others have not acquired the critical capacity to follow suit. Enhancing the linkage between services trade and employment represents a major development challenge.

89. At the national level, building productive capabilities and enhancing export competitiveness require a comprehensive, integrated and coherent strategy. Regulatory and institutional frameworks tailored to local conditions are critical. Skill development, including within the existing workforce in services sectors, is important in promoting employment growth and structural change. Attracting investment in infrastructure, including ICT, is important. Improving and enforcing labour laws, supporting the creation of firms and providing basic social protection for all facilitate the transition from informality. Gender equity policies such as education and childcare provision could increase participation of women in services and improve job quality. Increasingly, countries seek to capitalize on services to promote transition to a green economy and create green jobs.

90. At the international level, efforts and cooperation are needed to advance the development-led services trade agenda. Designing the adequate content, pace and sequence of the liberalization process, and coordinating this process with national policies and regulations, is fundamental for creating an enabling environment to build national productive competitive capacities and create employment. Enhanced market access and cooperative measures such as regulatory cooperation to create a more facilitative policy environment, especially in the areas of export interest to developing countries such as the temporary movement of natural persons, and promoting common infrastructure and network development, innovation and greater value addition in services value chains, would also be important.