United Nations

TD/B/C.I/15

United Nations Conference on Trade and Development

Distr.: General
28 March 2011

Original: English

Trade and Development Board
Trade and Development Commission
Third session
Geneva, 6–10 June 2011
Item 4 of the provisional agenda

Assessing the evolution of the international trading system and enhancing its contribution to development and economic recovery

Note by the UNCTAD secretariat

Executive summary

Trade-led growth remains key to countries' post-crisis development strategies. While conventional wisdom has argued unambiguously that freer trade would lead to growth, jobs and development, research and experience have confirmed that gains from trade are highly conditional on underlying productive capacities, regulatory and institutional frameworks, and complementary domestic policies, including labour market policies. The content, depth, sequencing and pacing of liberalization matter. There is a need for more explicit treatment of policies supporting productive capacities, economic diversification and upgrading into value addition, which also support job creation and labour market adjustments, within comprehensive trade and development strategies. The necessity of different policy instruments makes it incumbent on the international trading system (ITS) to provide greater policy space as an enabling instrument of development. The conclusion by the end of 2011 of the Doha Round, with strong development content and specific provisions for effectively supporting developing countries' productive and export capabilities, is important. Particular attention needs to be paid to maximizing its positive impact on employment and minimizing possible negative effects.

GE.11-

Introduction

1. As countries struggle to place their post-crisis economies onto a sustained development path, trade unquestionably remains an important instrument. There is increasing recognition that trade-led growth strategies should be complemented by proactive policies – industrial, agricultural and services – for enhancing production capabilities, structural transformation, economic diversification, value-addition, and human capital formation. Export-led and demand-led growth strategies need to be combined. Employment creation should feature prominently, as the crisis – including through its impact on trade – affected labour markets severely, aggravating chronic unemployment, inequality and the informal economy. Job creation is essential for the attainment of the Millennium Development Goals (MDGs), particularly Goal 1 on poverty reduction. The changing orientation in development strategies increases the relevance of the ITS to national development strategies. Trade liberalization and trade disciplines are increasingly affecting trade and industrial policies, as well as the labour market.

I. Recent developments

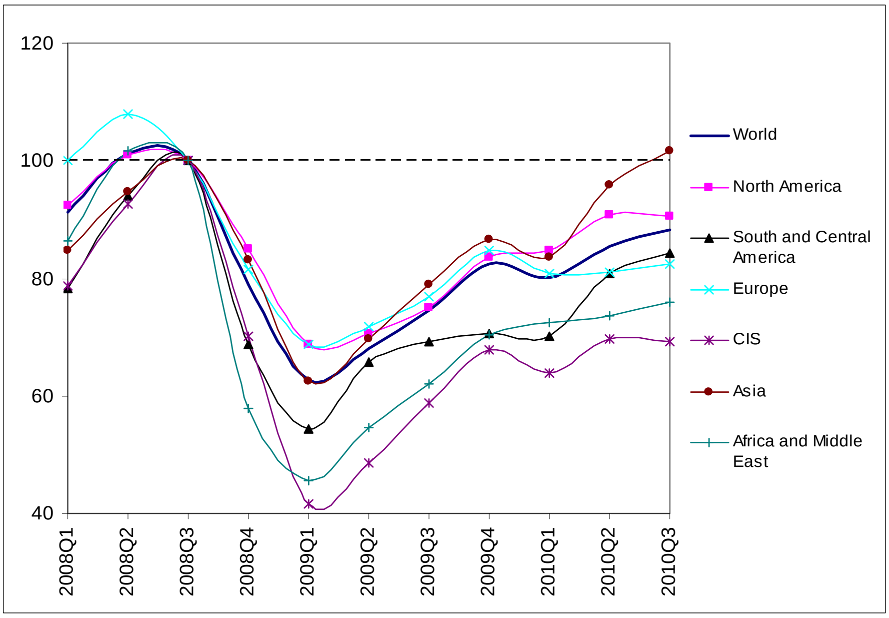
A. Developments in economic and trade recovery

2. The world economy continues its “two-speed” recovery, characterized by the dynamic growth of developing countries. Following its 2 per cent contraction in 2009, global gross domestic product (GDP) was estimated to grow by 3.6 per cent in 2010. With a projected growth rate of 7.1 per cent in 2010, developing countries were expected to outpace developed countries (at 2.3 per cent).[1] Recovery has been especially strong in Asia (notably in China, India and Indonesia) and in Latin America (notably in Brazil). Africa and the Least Developed Countries (LDCs) were forecast to grow by 4.7 and 5.2 per cent respectively. World trade in goods and services was expected to rebound by 11.4 per cent in 2010 after having decreased by 11 per cent in 2009.[2] Robust developing-country import demand in 2010, including from China and the Republic of Korea, boosted global exports, sustaining developed countries’ recovery. Developing countries were estimated to realize an 11.9 per cent export expansion in 2010, following the 7.8 per cent contraction in 2009 – as compared to 11 per cent for developed countries, which is still insufficient to compensate for the deep decline in 2009 of 12.9 per cent. The recent major disasters in Japan could reduce its output in 2011 and affect trade, including through some global supply chains.

3. By October 2010, in value terms, world merchandise exports were 12 per cent below their pre-crisis levels (fig. 1). Merchandise exports in 2010 from Japan, the United States and the European Union (EU) were forecast to increase by 27.3 per cent, 15.9 per cent and 10.9 per cent respectively. Only Asia has regained its pre-crisis levels, with Bangladesh, Viet Nam and the Philippines exhibiting strong growth. Asia’s export dynamism suggests a rapid rebound in import demand for final products transmitted throughout regional supply chains. Commonwealth of Independent States (CIS) and Africa/Middle East exports were still 30 and 24 per cent below their pre-crisis levels respectively, owing to their export concentration on fuels, whose prices remained lower throughout 2009–2010 than at their pre-crisis peaks despite hikes in early 2011. Sectorally, uneven paths emerged, as food, chemicals and machinery edged towards their pre-crisis levels (fig. 2).

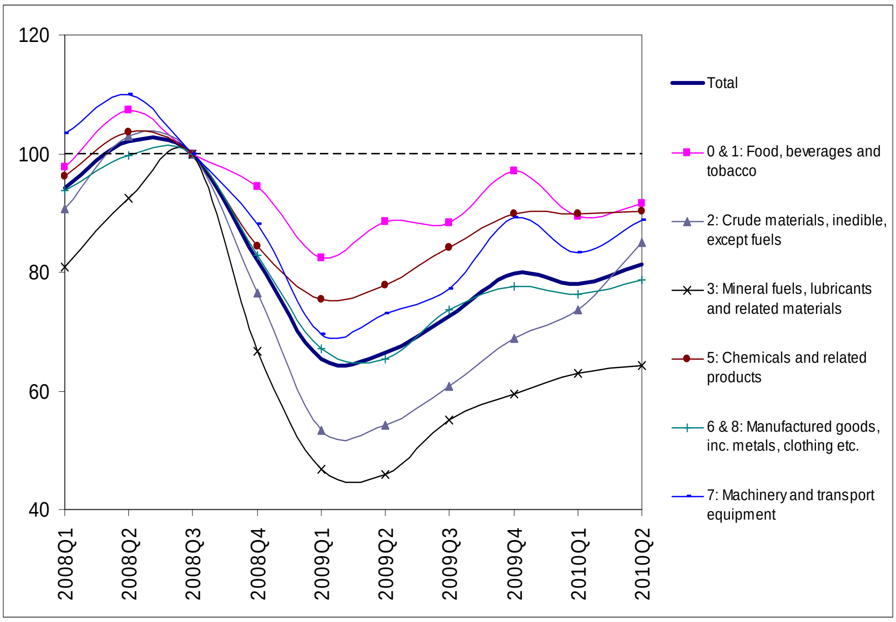
[1] United Nations (2011). *World Economic Situation and Prospects 2011*.
[2] IMF (2010). World Economic Outlook. October.

Figure 1. Merchandise exports, by region (2008Q3=100)



Source: UNCTAD, based on WTO online short-term merchandise trade statistics.

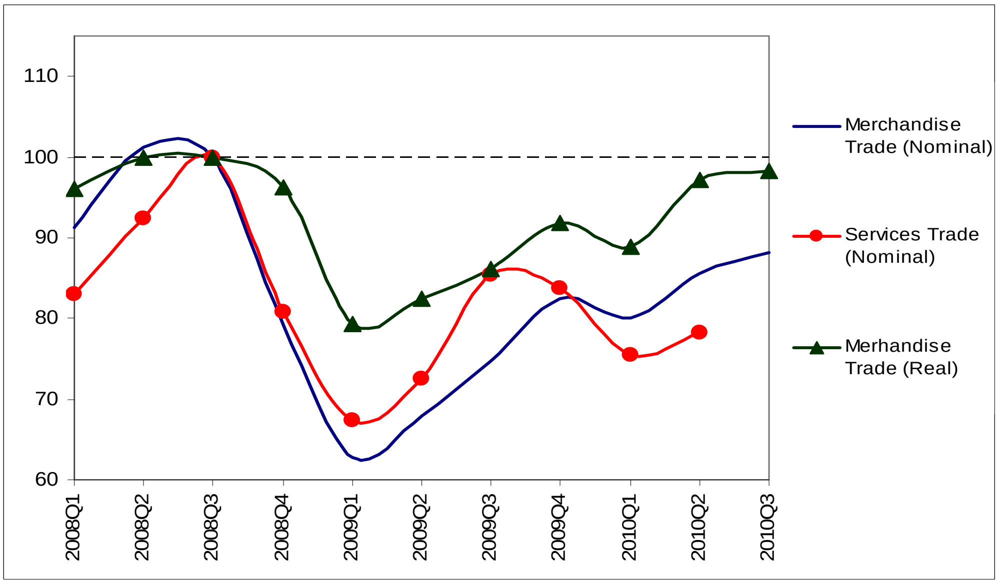
Figure 2. OECD imports, by product (2008Q3=100)



Source: UNCTAD, based on OECD.Stat.

4. The significant incidence of price effect is discernible also from the two different export trajectories in value and quantity terms (fig. 3). In quantity terms, by October 2010, world merchandise exports almost reached its pre-crisis levels. While the stronger recovery in volume terms reflects progress in real economic activities, lower export prices constrains earnings of commodity exporters.

Figure 3. World merchandise and services exports (2008Q3=100)



Source: UNCTAD, based on WTO online short-term merchandise trade statistics and the IMF balance of payments statistics.

5. Developing countries have emerged as more important export destinations, helping many to resist global demand contraction during the crisis (table 1). The share of developing countries as export destinations increased at an accelerated pace in 2009, indicating a faster growth of exports to developing countries than to others. The share of South–South trade increased by 2.8 percentage points in 2009 as compared to 1.2 percentage points during 2000–2007. Africa posted a remarkable export-destination switch to the South, with the share of developing countries in its exports increasing by 6.1 percentage points in 2009. Such a relative expansion of import demand was spread across a wide range of developing countries and products.

Table 1. Share of developing countries as export destination

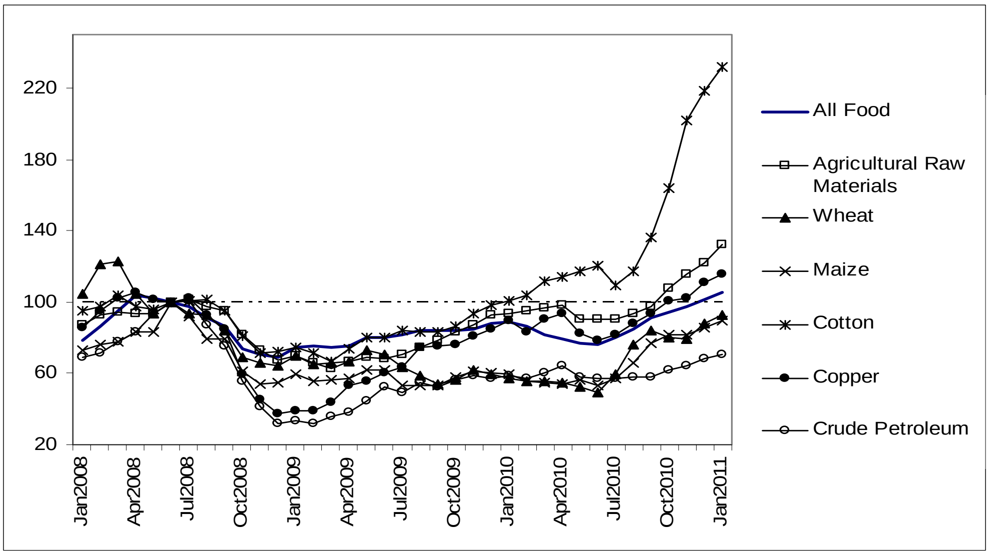
	Share (as percentages)			Change in share (as percentages)		
Exporters	2007	2008	2009	From 2000 to 2007 (average)	2008	2009
Developed countries	*23.3*	*24.4*	*26.2*	*0.1*	*1.0*	*1.9*
Transition economies	*19.7*	*20.0*	*23.1*	*0.1*	*0.3*	*3.1*
Developing countries	*49.1*	*51.0*	*53.7*	*1.2*	*1.9*	*2.8*
Developing Africa	*32.9*	*33.8*	*39.9*	*0.8*	*0.9*	*6.1*
Developing America	*32.7*	*35.5*	*37.6*	*1.4*	*2.8*	*2.0*
Developing Asia	*53.9*	*55.9*	*57.9*	*1.1*	*2.0*	*2.0*

Source: UNCTADStat database online.

6. Food commodities exceeded their historical peaks in early 2011, resuscitating global concern over food security (fig. 4). In 2010, wheat prices rose by 63 per cent and maize prices by 51 per cent. This increase largely reflects supply shocks. Some differences from the 2008 food crisis have been noted, including generally higher levels of existing supply, a less concentrated market for wheat (unlike rice, which saw major price hikes in 2008), and smaller increases in domestic prices, with international price increases partly reflecting depreciation of the United States dollar. Crude oil prices surged in early 2011, surpassing

$100 per barrel, in response to instability in some oil-producing countries. Higher oil prices further pushed up price levels by increasing input costs (e.g. transport and fertilizer). Agricultural raw materials – particularly cotton – exceeded their historical peaks by 30 per cent. Industrial metals – particularly copper – registered robust increases, with expansion of demand in emerging economies.

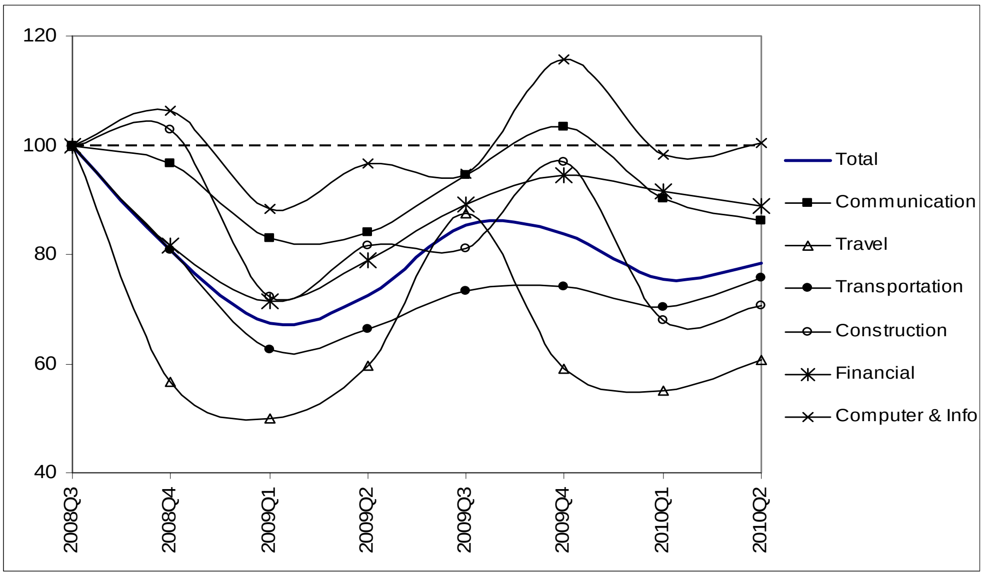
Figure 4. Selected commodity price indices (June 2008=100)



Source: UNCTADStat database online.

7. Trade in services is generally considered as "crisis-resilient", as some national data indicated smaller fluctuations during the crisis. Figure 3 reveals that services exports were affected by the crisis too (to an extent similar to merchandise trade) with their value remaining 22 per cent below the pre-crisis level. Some sectors – transport, travel and construction – registered greater volatility than others (e.g. computer and information technology) (fig. 5). Construction is among the hardest hit, while the sluggish recovery of merchandise trade has delayed the recovery in transport services. Financial services remain weak. Travel services have a strong seasonal pattern, but are vulnerable to natural disasters and political instability. The ICT sector showed less volatility.

Figure 5. Indices of services exports by sector (2008Q3=100)



Source: UNCTAD, based on IMF balance of payments statistics.

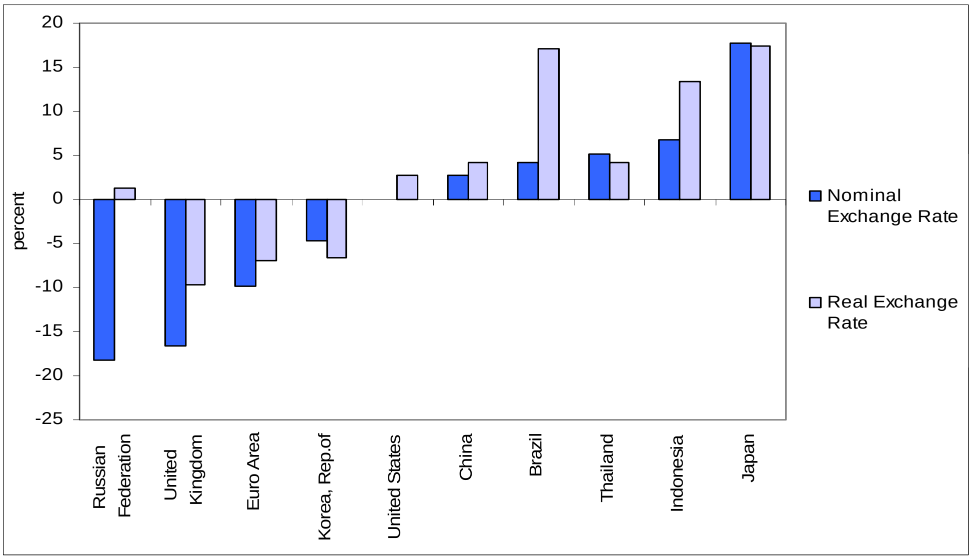
8. Tourism has become a key export and employment-creating sector for many countries. World tourism receipts fell to $852 billion in 2009. In 2010, global tourist arrivals grew strongly (by 6.7 per cent) to a record high of 935 million, exceeding by 22 million the former peak year of 2008. In 2011, tourist arrivals are forecast to grow by 4–5 per cent, although instability may impact the sector.

9. Remittances were relatively resilient to the crisis. In 2010, remittance flows to developing countries increased by 6 per cent to reach $325 billion, following a 5.5 per cent contraction in 2009.3 Low-income countries registered particularly strong growth (8.2 per cent). Remittances represented 4.5 per cent of developing countries' GDP, and nearly 30 per cent in some low-income countries. The development impacts of remittances can be strengthened by formalizing flows, establishing an enabling regulatory framework, developing financial products, the use of new technologies, financial education and inclusion for recipients and migrants, migrant entrepreneurship training, assistance to small and medium-sized enterprises (SMEs) and securitization (e.g. through diaspora bonds).4

10. Concern over currency and trade "wars" emerged from increased capital inflows to developing countries and the weakening of some currencies. The concern was heightened by the second United States "quantitative easing" and the weakening of the United States dollar. This boosted United States exports while weakening developing-country trade competitiveness as developing countries' currencies appreciated (fig. 6). This prompted several countries (e.g. Brazil, Thailand) to resort to capital controls, which has been more widely accepted. This new episode adds to the debate over China's currency in the context of global rebalancing. Figure 6 also reveals that the Chinese currency appreciated modestly, while the pound and the euro experienced sharp depreciation. Currency depreciation can act as export subsidies and affect developing-country exports.

[3] World Bank (2010). *Migration and Remittances Factbook 2011*.
[4] UNCTAD (2011). Maximizing the development impact of remittances.

Figure 6. Change in nominal and real effective exchange rates, 2008–2010

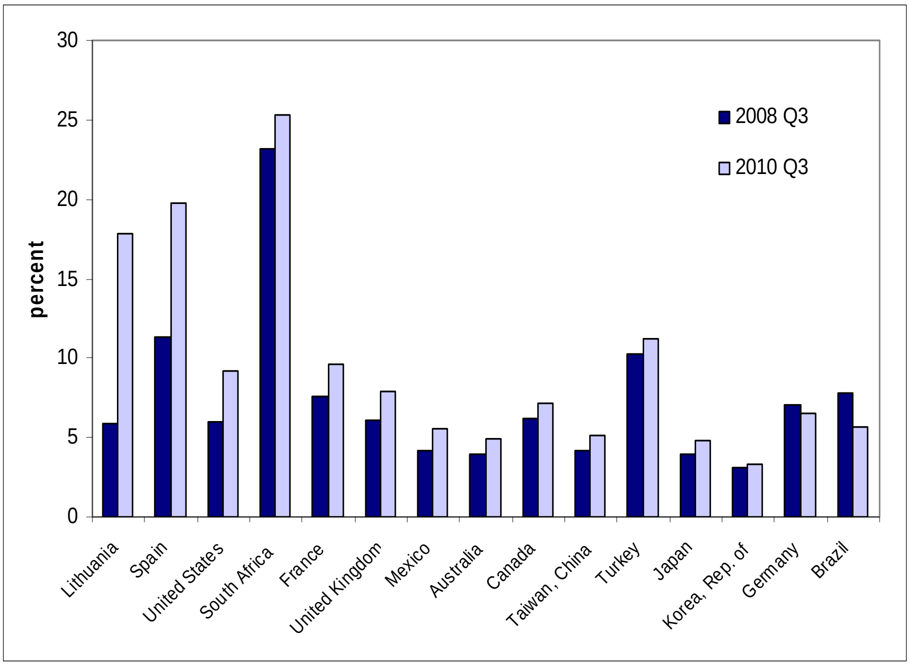


Sources: UNCTAD, based on IMF's International Financial Statistics and the Economist Intelligence Unit's Country Data.

11. Global imbalances affect prospects for sustainable growth and need to be addressed. Current account deficits are expected to expand in the United States after a sharp fall in 2008. In 2010, the surplus in China stood at $306 billion and the deficit in the United States at $494 billion. Countries with pre-crisis surpluses – China, Germany and Japan – are expected to preserve their surplus positions in the near future. Brazil has shifted from surplus to deficit, following capital inflows and currency appreciation. Setting numerical targets to limit the size of the imbalances has been on the agenda at the G-20, including proposals to limit such imbalances to 4 per cent of GDP. IMF will monitor external imbalances, including the trade balance and investment income flows and transfers.

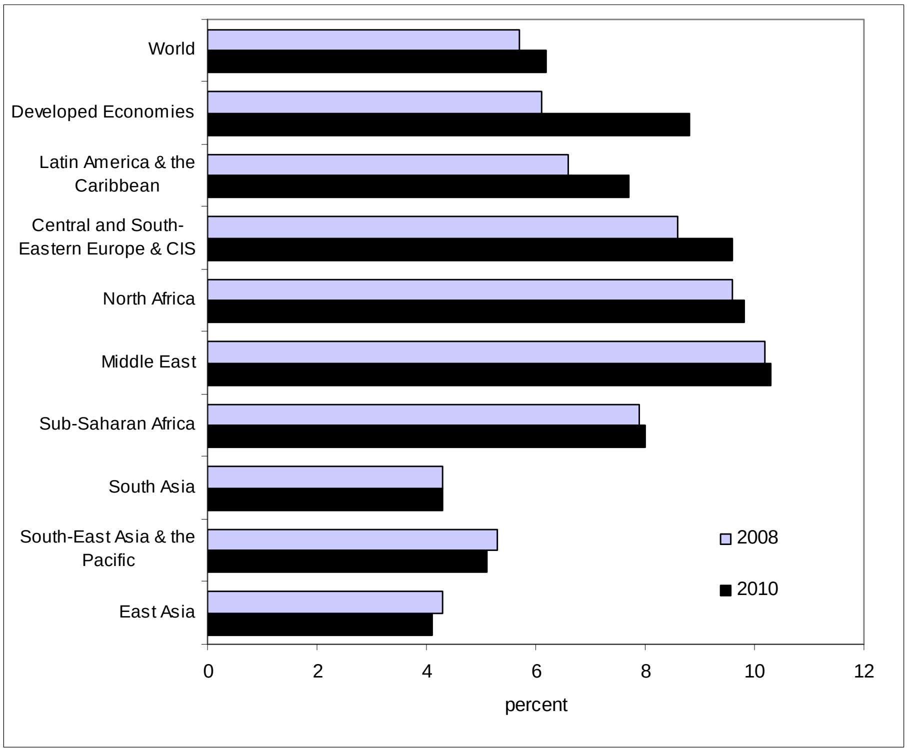
12. Large and prolonged unemployment characterizes the post-crisis period, although in late 2009 unemployment started to retreat. Globally, 210 million were unemployed in 2009, with three quarters of new cases of unemployment occurring in developed countries. Deferred growth risks (a) transforming cyclical unemployment into structural unemployment; and (b) aggravating pre-existing labour market imperfections including pervasive unemployment, market segmentation, inequality, youth unemployment, slow wage growth, and dual economy. Those countries directly exposed to the real estate and banking crisis registered a strong surge in unemployment (fig. 7). Developing countries are characterized by a large informal economy (60 per cent of the work force ((78 per cent in Asia, 52 per cent in Latin America and 56 per cent in Africa)), which is marked by lower wages and less job security. Some countries were successful in reducing unemployment, including Brazil owing to its robust economic and trade growth, and Germany thanks to its work-sharing policies and return of exports. South Africa stands out with its high unemployment.

Figure 7. Unemployment rate in selected countries



Source: UNCTAD, based on ILO's LABORSTA.

Figure 8. Unemployment rate by region

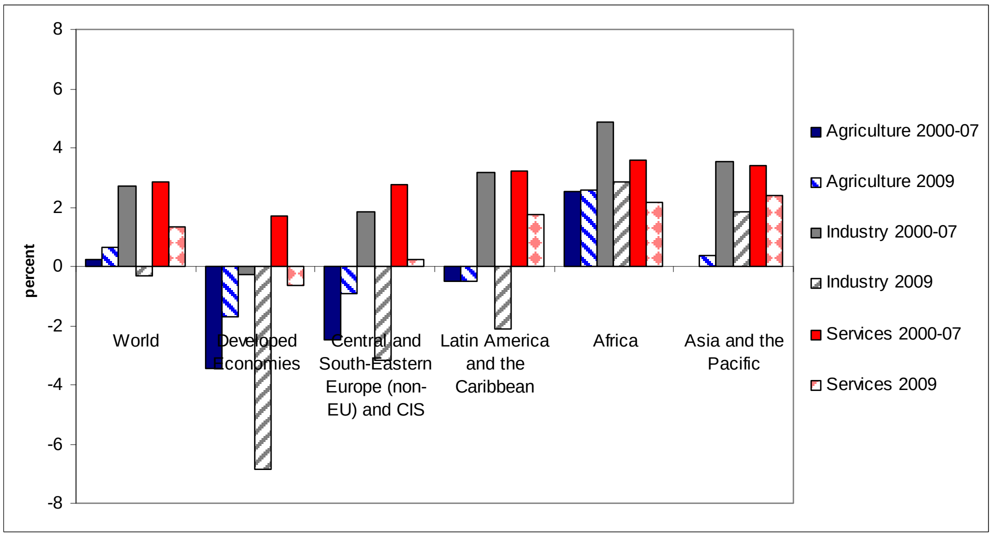


Source: ILO. Global Employment Trends 2011.

13. Workers were affected by the crisis as job losses occurred in export sectors starting in late 2008 when global trade collapsed. Further losses followed as domestic demand fell, especially in construction. Some workers were absorbed into informal sectors. Sectoral

evolution confirms significant employment losses in industry in developed and transition economies (fig. 9); in these economies the agriculture and services sectors did not absorb the increased numbers of unemployed, as almost all sectors exhibited loss. Africa and the Asia-Pacific region continued to create employment in 2009. In 2010, particularly in developing countries, unemployment rates started to decline in East and South-East Asia, (fig. 8) with strong job growth in manufacturing, construction and services.[5]

Figure 9. Sectoral employment growth rates



Source: UNCTAD, based on ILO Global Employment Trends 2011.

B. Developments in the international trading system

14. The sustainability of the economic and trade recovery will be affected by developments in the international trading system (ITS). The ITS has been undergoing a major structural transformation as economic power and opportunities shift to the South with the rise of emerging developing countries; this has given rise to a multi-polar trading system.

15. The Doha Round is in its tenth year, and its conclusion by the end of 2011 has been targeted. The G-20 summit in Seoul in November 2010 and the informal Davos mini-ministerial meeting in January 2011 reiterated this commitment. The working hypothesis is to produce texts by April and reach agreement on them in all areas by July. This requires significant and timely progress to be made, however the pace of progress has been reported as too slow to forge tangible breakthroughs. "Horizontal" negotiations for cross-sectoral trade-offs are being held in small-group discussions, including among eleven countries (the "G-11").[6] Other countries have stressed the importance of multilateral processes, as small-group agreement could have implications for transparency and balance in the entire package.

16. Recent discussions pertain to participation by larger developing countries in deeper sectoral liberalization in non-agricultural market access (NAMA), and a possible "exchange

[5] ILO (2010). *World of Work Report 2010.*

[6] United States, European Union, China, India, Brazil, Japan, Australia, Canada, Argentina, South Africa and Mauritius.

rate" of concessions by developed countries in other areas, especially in agriculture. While the participation in sectorals is "on a voluntary basis", developed countries have sought to secure the participation of larger developing countries in at least two of the three key sectors of chemicals, industrial machinery, and electronics. They have sought to ensure "real market access" in larger developing countries. Stronger commitments by developing countries in GATS Mode 3 to bind, inter alia, the existing level of openness relating to local presence requirements and foreign equity limitations, have also been proposed. Developing countries point to the imbalance in such an approach, as no compensatory concessions are reciprocated, particularly in product-specific market openings in agricultural products (e.g. beef and poultry) and domestic support, or in services sectors and modes of interest to developing countries.

17. Negotiations are yet to effectively address some of the issues of importance for developing countries. These include effective reduction in trade-distorting agricultural domestic support, simplification of complex tariffs into simpler ad valorem tariffs, tariff quota creation associated with sensitive products, details of special safeguard mechanisms (SSM) to better safeguard food security, mitigating the effects of preference erosion, country-specific flexibilities in NAMA including for members of customs unions, and commercially meaningful services market access in Modes 4 and 1. LDCs have called for an early harvest of LDC packages, including full implementation of duty-free and quota-free (DFQF) market access, a most favoured nation (MFN) waiver to cover preferential services market access for LDCs, an ambitious solution on cotton, and fast-tracked LDC accession with equitable terms. It is notable that the United States' Generalized System of Preferences (GSP) scheme expired at the end of 2010, while its renewal and reform are relevant to meeting the 97 per cent target for product coverage under DFQF market access.

18. The apparent lack of willingness to take leadership, including in making concessions and compromises, indicates domestic constraints in all countries in reconciling different national sensitivities and securing a package that would be acceptable to their constituencies. For instance, the greater emphasis placed on sectoral liberalization in developing countries in NAMA, or more restrictive SSM in agriculture, reflects the export interests of developed countries with large trade deficits facing the imperative of rebalancing their growth patterns. This affects developing countries' development objectives of basing their growth on sound labour-intensive agricultural, manufacturing and services capacities and employment. The direct effects of the crisis – weak growth and persistently high unemployment – further limit countries' negotiating scope. The recent appreciation of developing countries' currencies, eroding their export competitiveness, has further constrained these countries (e.g. Brazil's external balance turned from a surplus into a deficit in 2006–2010).

19. The prolonged Round, and prospects for deeper market access and rules, have driven a proliferation in regional trade agreements (RTAs), with 197 RTAs now in force. Greater involvement by Asian countries indicates that countries are partnering regionally with dynamically growing markets. While momentum has slowed down for comprehensive economic partnership agreements (EPAs) between the EU and the ACP (African, Caribbean and Pacific) Group of States, the EU has embarked on "competiveness-oriented" RTAs with emerging economies and resource-rich countries, including the Republic of Korea, India, Mercosur and ASEAN. The United States has begun negotiations on a Trans-Pacific Partnership Agreement with eight Pacific Rim countries. While possibly facilitating subsequent multilateral liberalization, RTAs run the risk of weakening incentives to negotiate multilaterally, as key economic interests are increasingly addressed regionally. There is a need for stronger developmental coherence in RTAs and the multilateral trading system (MTS), and hence to consider incorporating Special and Differential Treatment (SDT) in GATT Article XXIV to allow for less than full reciprocity (LTFR) for developing countries in regional contexts.

20. Interregional South–South trade cooperation has received new impetus, with the conclusion in December 2010 of the São Paulo Round of Global System of Trade Preferences (GSTP) negotiations, launched in 2004 at UNCTAD XI. Twenty-two of the 43 GSTP members participated in the São Paulo Round. Eleven of these 22 participants[7] exchanged tariff concessions amongst each other; some countries that had not completed tariff negotiations by that time were expected to join shortly. Imports by the 11 countries signing the agreement were around $1 trillion in 2009, of which 10 per cent was intra-trade among the 11 countries. By broadening product coverage to 47,000 tariff lines and cutting applied tariffs by 20 per cent on 70 per cent of dutiable products, the results inject a strong boost to intra-group trade. GSTP participants will examine a possible modification of the GSTP rules of origin, currently based on value-added methods, including the examination of tariff-classification methods.

Box 1. The GSTP São Paulo Round

The 43 GSTP participants represent 20 per cent of world trade, and intra-GSTP trade among the 22 participants in the Round accounts for 16 per cent of their total exports to the world. UNCTAD's GTAP analysis shows that the results of the Round will induce a positive effect on participating countries, with a 3 per cent growth in their intra-group trade, and welfare and employment increases in all participants.

	Welfare effect (millions of dollars)	Change in unskilled labour Per cent	Change in total employment Per cent
Egypt	52	0.09	0.00
India	1,222	0.15	0.12
Indonesia	426	0.12	0.10
Rep. Korea	1,744	0.26	0.18
Malaysia	471	0.37	0.28
Mercosur	345	0.03	0.02
Morocco	150	0.26	0.20
Other 11	1,438	0.13	0.09

Source: UNCTAD.

Note: Data for Cuba not available.

Total welfare in the 22 countries would increase by $6 billion, and in all countries, employment would increase. The employment of unskilled workers would increase by 0.15 per cent in India and by 0.37 per cent in Malaysia, with possible poverty reduction effects. The results show a positive impact on growth and employment. If the remaining GSTP countries also reduced their tariffs, the positive effects could be considerably higher.

21. Systemically, further prolongation of the Doha Round raises a credibility issue for the World Trade Organization (WTO). An interim report by a high-level trade experts' group co-chaired by Professor Bhagwati and Mr. Sutherland suggested making the end of

[7] Cuba, Egypt, India, Indonesia, Republic of Korea, Malaysia, Mercosur and Morocco.

2011 an inflexible "absolute deadline" with the negotiations to be abandoned thereafter.[8] The issue remains as to whether the new deadline is seen as credible enough to encourage the much-needed movement. The stakes are high, as "abandoning the Round and attempting to relaunch a WTO agenda around renegotiating objectives would be extremely unlikely". Reinforcing the long-term viability of the MTS appears to be the strongest case for concluding the Round. While the potential welfare gains of the Round may not be as high as originally estimated, it is expected to provide a boost to the global economy. UNCTAD's analysis, confirming other recent studies, projects global gains of $64 billion. The value of the MTS was significant in maintaining an open market during the crisis, while cooperative efforts at the G20, monitoring, and the strong self-restraint shown by developing countries also played their part. WTO estimates that between November 2009 and October 2010, at most 1.2 per cent of world trade was affected by such measures and their impact was of minor magnitude (0.25-2 per cent). WTO provides an essential institutional guarantee against protectionism in a rules-based system.

22. The current architecture and instruments of the MTS embodying conventional economic thinking is increasingly less effective in addressing rapidly evolving economic realities and development challenges.[9] Its focus could be broadened beyond mercantilist reciprocity-based market openings to encompass broader developmental objectives. The MTS's institutional reform also deserves attention. A broad-based agenda under a single undertaking has so far failed to facilitate inter-sectoral trade-offs on issues of vital interest. This is in part due to the legally binding nature of commitments in the MTS backed up by dispute settlement mechanisms, which, despite their merits, have made countries cautious in making further commitments. Consideration could be given to experimenting with innovative forms of commitments and processes, including those without a linkage to dispute settlement, allowing for some room for (temporary) rollback. Such commitments and processes could rely more on undertakings subject to regular review based on the development impacts of the commitments and on support measures to help developing countries to implement and benefit from the commitments, as well as on sectoral/plurilateral liberalization approaches in areas ripe for liberalization. Enhancing development dimensions and institutional reform could buttress the MTS's relevance and effectiveness.

II. Trade, productive capacities and employment

23. The recovery in trade and employment can be seen as indicative of countries' trade and development strategies. Some Asian countries have registered a stronger recovery in trade and employment than others. Such divergent country experience highlights the necessity of developing countries building productive capabilities and creating employment so that their trade integration and growth are sustainable and inclusive. This raises the question of the relationship between trade, the trading system, industrial development and employment, appropriate polices and a coherent strategic framework.

[8] High-level Trade Experts Group (2011). *The Doha Round: Setting a Deadline Defining a Final Goal*. January.
[9] United Nations (2010). A/65/211. 2 August.

A. Trade, industrial policy and development

24. Economic thinking on trade, the role of the government, and development has seen a major evolution over the past three decades. Liberalization and market-oriented reform have dominated the mainstream development economics. This view sees access to foreign technology, imports and good institutions as necessary and sufficient conditions for economic growth, giving limited attention to proactive trade and industrial policies, and limiting the governments' role to eliminating market distortions and "getting prices right". This view is grounded in neoclassical growth theory and studies documenting the distortionary effects of interventionism and import substitution policy. Proponents of this thinking claimed that "open" economies experienced faster growth.

25. The disappointing performance of sub-Saharan African countries that underwent structural adjustment programmes in the 1980s and 1990s without a strong domestic industrial base, and the rise of East Asian tigers that successfully combined state interventionism supporting industrialization with export-led growth, have presented a strong case against neoclassical growth theory and laissez-faire policy prescriptions. The positive association between import openness and growth has been seriously questioned. Evidence has emerged that industrial policy and proactive trade policy, including time-bound protection, has been successful. Countries that followed the Washington Consensus at certain times did not post higher growth for those periods than the periods in which they followed proactive policies.[10]

26. While trade is an important ingredient in recent development success stories, studies have found that successful countries have protected and developed their domestic industries and manufacturing base before proceeding to open their markets and actively participate in trade through selective export-promotion policies, often combined with import replacement. In such cases, the government has played a central role in mobilizing domestic investment and foreign direct investment (FDI) and in influencing its allocation, including through public enterprises to enter risky sectors, while a range of policies have been used to increase the production capacity to accelerate diversification and upgrading. Policies aimed at human capital development through investment in education, R&D, the development of technological and physical infrastructure, competitive exchange rates, and the moderation of wage increases have been among the accompanying measures. The crisis further confirmed the government's role in an economy, especially as developmental States. Various researches have identified the contours of modern industrial policies adapted to an open economy, stressing more incentives and support in existing comparative advantage, rather than "picking the winners" (box 2).

[10] Hausmann and Rodrik (2003). Economic development as self-discovery. *Journal of Development Economics.*

Box 2. Industrial upgrading and economic diversification

The quality and degree of technological sophistication are more important than the volume of exports. Hidalgo and Hausmann (2009) submit that the wealth of a country is tightly connected to the set of products and services that it can deliver to world markets given endogenous productive capabilities ("product space").[11] Since specialization in some products brings higher growth than in others, governments can influence a nation's specialization and thus its development path. Lin (2010) suggests practical steps to do this, based on a list of goods and services produced for 20 years in dynamically growing countries with similar endowment structures and with a GDP per capita of 100 per cent higher than the country under examination.[12] Governments can give priority to industries that domestic firms have already entered and can help remove obstacles to their development, or, if no domestic firms exist, they can adopt measures to attract firms from high-income countries to invest in these industries.

B. Trade and employment

27. The link between trade and employment is complex. Many jobs are directly dependent on trade. Empirical evidence suggests that the degree of trade openness is not an important determinant of overall employment. Little correlation is found between trade liberalization and an overall level of employment. It has been shown for OECD countries that neither the share of the employed population or the rate of unemployment is correlated with trade openness – a finding also confirmed for developing countries. Some authors conclude that the "direct effects of trade reform on aggregate employment are muted", with some evidence showing that the impact of trade liberalization operates more through wages than employment, depending on labour market characteristics.[13]

28. While market opening may not affect the aggregate level of employment, it leads to labour relocation between firms and sectors. This structural change is the source of welfare gains from trade, as resources are employed more efficiently. There is evidence of some negative impact of import competition on sectoral employment. Studies have found that a 1 per cent increase in import penetration is associated with a 0.6 per cent decrease in sectoral employment in the United States; that the increase in overall import penetration in Argentina during 1991–2003 could explain 20 per cent of the loss in manufacturing employment; that greater openness in Brazil reduced jobs through increased job destruction, alongside other factors (e.g. labour costs); and that in Morocco, a 21 per cent decline in tariff protection was associated with a 4 per cent decline in employment in textile, apparel and beverages.

29. While higher import levels seem to reduce employment in import-competing sectors, an important question is whether employment rises in sectors that increase exports. Studies for Latin America show that job destruction is higher than job creation, at least for several years after liberalization. For instance, trade opening in Brazil and Uruguay resulted in greater job destruction in formerly protected industries than job creation.[14] Displaced workers were not absorbed by the competitive industries, but moved into non-trading

[11] Hidalgo and Hausmann (2009). The building blocks of economic complexity. Proceedings of the National Academy of Sciences: 106.

[12] Lin (2010). Six steps for strategic government intervention. *Global Policy.*

[13] Hoekman and Winters (2007). Trade and Employment. In: Ocampo, Sundaram and Khan. *Policy Matters.*

[14] Casacuberta and Gandelman (2010). Protection, openness and factor adjustment.

sectors or out of formal employment. In Brazil, the rise in informal employment has largely coincided with trade liberalization. One likely reason is the increase of the average productivity in the export sectors. Another might be that the reallocation of factors between sectors is lower than suggested by traditional trade models, with more churning happening within sectors than between sectors.

30. Aggregate adjustment costs are seen as normally smaller than the long-term benefits. Recent analysis shows, however, that the adjustment costs can be high, especially in very rigid labour markets. It is possible that positive long-run gains are offset completely.[15] Labour appears to bear the bulk of the costs. Some analysis has found substantial negative effects from trade liberalization on labour markets both in developed and developing countries. Some authors conclude that these studies raise important doubts about the previously held view that trade liberalization would yield benefits in the long run.[16]

III. Strategies for productive capacity-building and employment creation

31. Since the majority of developing countries (113 out of 162) record a trade deficit, export-led growth strategies remain imperative to them. The successful strategies and empirical evidence discussed above make a strong case for complementing trade-led growth with policies aimed at creating a productive capacity base and employment. The labour market policies implemented during the crisis were important in containing unemployment. The International Labour Organization (ILO) estimates that without the discretionary fiscal measures and automatic stabilizers, global unemployment would have risen by 55 million, instead of 34 million. In post-crisis growth strategies, countries have sought to build productive capacities and employment by mobilizing trade and industrial policy instruments (e.g. tariffs, subsidies, government procurement, TRIMs and technology policies).

A. Relationship between trade and labour market policies

32. Labour market policies interact with trade and development strategies. In the long term, as labour costs are a major production cost component, labour market policies that influence labour costs (e.g. minimum wages) creating labour market “rigidity” could affect the long-term competitiveness of an economy. Labour market “flexibilities” and wage moderation have been pursued to preserve competitiveness and enhance growth potential, including under the export-led growth model. For developing countries, the issue is generally less acute, as labour market policies are underdeveloped. From the macroeconomic perspective, lower wages have the effect of weakening domestic aggregate demand.

33. In the short term, labour market policies can support employment preservation and creation by boosting labour demand and by supporting adjustments resulting from economic shocks, be they trade liberalization or cyclical downturn. Policies aimed at boosting labour demand interfaces with industrial policies, as they either directly support the productive capacities of industries and firms that create jobs (e.g. subsidies to SMEs), or boost demand for goods and services so that firms producing them expand their demand for workers (e.g. infrastructural expenditures). Such policies, in turn, have close links with

[15] François, Jansen and Peters (2011). Trade, adjustment costs and assistance.
[16] McMillan and Verduzco (2011). New evidence on trade and employment.

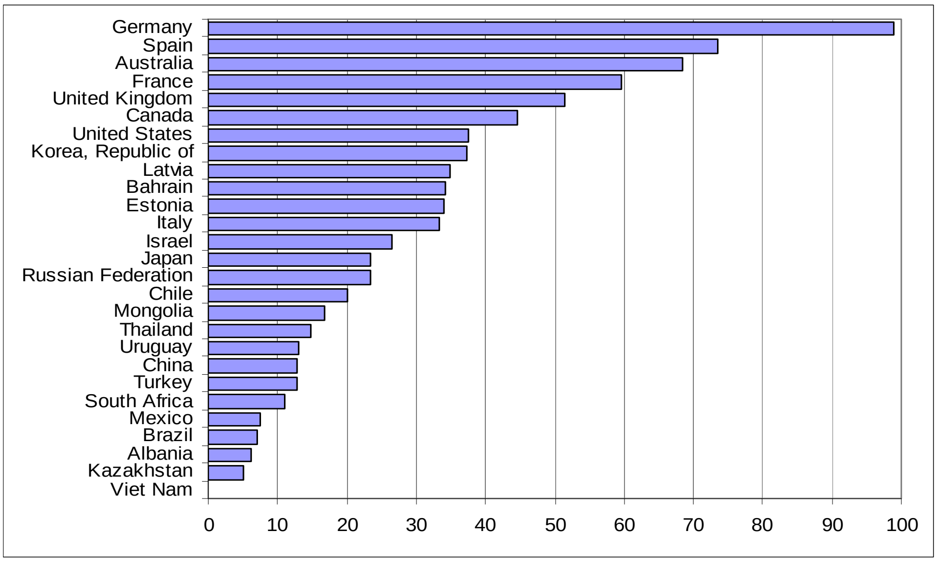
trade policy, as labour demand can be created in export sectors or import-competing sectors. Such a linkage suggests that labour demand-creating polices could be regulated by international trade disciplines.

34. Policies facilitating labour market adjustment to exogenous shocks are instrumental in increasing the likelihood for net welfare gains from trade liberalization. While "passive" labour market policies – e.g. unemployment benefits – minimize income loss to the affected workers, "active" policies addressing the interaction between labour supply and demand (training, wage and hiring subsidies) can increase the likelihood for workers to find new jobs, thereby smoothening structural adjustment. In general, these types of policies are not directly related to international trade disciplines, while some elements, including subsidies, might be seen as having some relevance.

Box 3. Labour market policies and trade liberalization

The ability of countries to implement "passive" labour market policies is highly asymmetric. ILO estimates that globally, 78 countries provide legal protection to the unemployed, covering 13 per cent of the world's total unemployed. In developing countries, only 7–13 per cent of the total unemployed population was covered by unemployment insurance in 2008. The high informality of developing-country labour markets limits the effectiveness of such policies.

Unemployed receiving unemployment benefits (percentage of total unemployed):



Source: UNCTAD, based on ILO.

B. Industrial and trade policies as an instrument of job creation

35. Given the interface between trade, industrial and labour market policies, a key issue in national growth and development strategies has been to enhance the contribution of trade and industrial policies to job creation, and to apply labour market policies strategically in support of trade liberalization processes, competitiveness and growth. Various post-crisis

growth strategies have placed special emphasis on job creation goals by mobilizing trade and industrial policy instruments, e.g. South Africa.[17]

36. EU 2020's "smart, sustainable and inclusive growth" sought to achieve a 75 per cent employment rate (from the current 69 per cent), including by supporting job creation, especially within SMEs, guided by the principle of "flexicurity" to promote labour market flexibilities for employers and protection for employees, and by developing a competitive and diversified industrial base through a new industrial policy (box 4). Trade policy is instrumental to this goal. While exploring export opportunities focusing on services, investment, public procurement, enforcement of IPR, and access to raw materials and energy, the EU seeks to protect EU production by deploying trade defense instruments against subsidization provided through export restriction to downstream industries.

Box 4. EU's "industrial policy for the globalization era"

The EU industrial policy seeks to create the best environment to develop a strong, competitive and diversified industrial base, and to support the transition of manufacturing sectors to greater energy and resource efficiency, by combining different policy instruments (e.g. "smart" regulation, modernized public procurement, competition rules and standard-setting). This policy is expected to improve the business environment, especially for SMEs, including by facilitating access to finance; promote restructuring towards future-oriented activities, including through State aid and/or the Globalization Adjustment Fund; promote technologies that reduce natural resource use; develop transport networks; enhance the competitiveness of the tourism sector; and support the transition of the services and manufacturing sectors to greater resource efficiency.

37. The United States' National Export Initiative aims to create millions of jobs by doubling exports by 2015. The strategies prioritize exports by SMEs through advocacy; trade missions; strengthening export financing and credit; enhancing export assistance and reducing barriers to trade, including through trade agreements under the Doha Round; FTA and TPP negotiations; enforcement, and export promotion of the services sector. The initiative adds to the existing "industrial policy" toolbox in the form of a decentralized technology policy,[18] including through granting tax credits for R&D, involving SMEs in federal research activities, promoting networks of companies and research institutions, and supporting manufacturing companies to upgrade their technological efficiency.

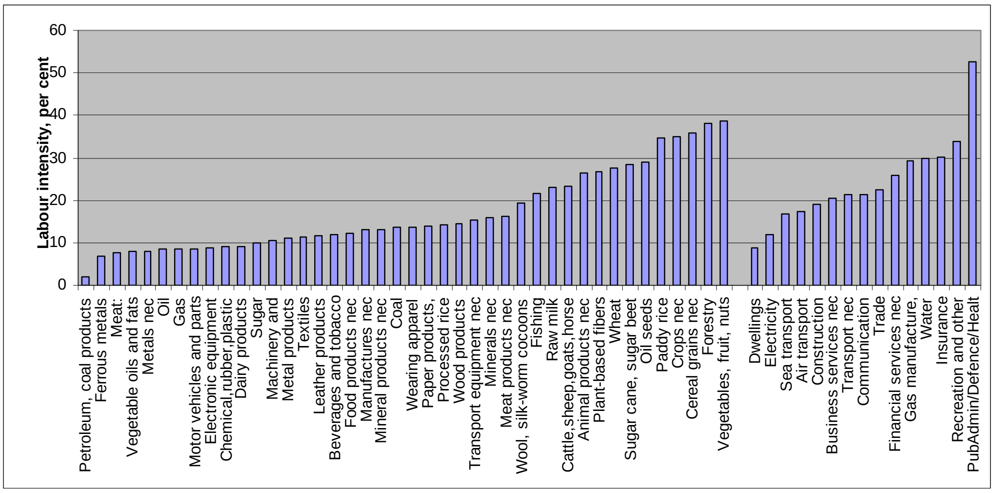
C. Increasing relevance of targeted policies

38. Trade policies can boost labour demand in the export sector and preserve jobs in the import-competing sectors. The employment creation/preservation effect can be greater if labour-intensive manufactures and services are targeted, including agricultural (e.g. cereals) and textile and clothing products (fig. 11). Certain services are more labour-intensive than others (e.g. recreation, financial and insurance services and business services). Countries following export-led strategies have often diversified into labour-intensive manufactures, as labour-abundant developing countries tend to have comparative advantage in such sectors. Industrial policies inducing diversification are important, as many developing countries specialize in the less labour-intensive minerals sectors. Adequate tariff protection could be instrumental in nurturing domestic capacities. South Africa envisages the selective use of

[17] UNCTAD (2010). "Successful trade and development strategies for mitigating the impact of the global economic and financial crisis". (TD/B/C.I/7).
[18] Schrank W (2009). Industrial policy in the United States. *Politics and Society.*

tariffs as an industrial policy instrument, where there is potential for significant creation and retention of sustainable jobs or import replacement.

Figure 11. Labour intensity of products and services



Source: UNCTAD, based on GTAP 7.

39. Government procurement, representing 10–20 per cent of GDP, can be used as an instrument for boosting demand for goods, services and labour. Countercyclical public spending on infrastructure projects has aimed to achieve this goal. Such spending has targeted sectors with greater job-creation effects where labour intensity is high, including infrastructure and SMEs, especially in machinery, garments, automotives, construction and transport. In the United States, about 59,300 new jobs have been created under the $4.4 billion infrastructure spending, especially in construction and transport. To increase the effects of job creation, policies are targeted to local suppliers and labour-intensive firms and sectors. Preferential procurement policy plays a key role in South Africa's industrial policy.

Box 5. Industrial policies and trade disciplines

Subsidies, including local content subsidies, have historically assisted in industrial development, including in the textiles, aircraft, transport and energy sectors. Local content subsidies are currently prohibited under WTO rules. Developing countries have sought to make certain types of subsidies "non-actionable", including for regional development, R&D and product diversification. Historically, local content requirements were also used to regulate FDI in strategic sectors, including the automotive sector, to promote localization of value-added production. In the past, some developed countries applied a local content requirement of 75–90 per cent on carmakers. WTO prohibits TRIMs conditional on local content requirements. Government procurement has been used as industrial policy tool, and various "buy national" (i.e. local content) laws have been implemented. Such policies have contributed to the development of aircraft industries. Since many developing countries are not parties to WTO's Agreement on Government Procurement, they preserve the flexibility to use local content requirements. Such policy space is important for developing countries to implement trade and industrial policies.

Source: UNCTAD (2010). Evolution of the international trading system and of international trade from a development perspective. TD/B/57/3.

40. Various national programmes target SME development, as SMEs are major employers. A combination of subsidies, government procurement and export promotion are mobilized as key policies. Access to finance is important, as SMEs depend on bank finance for working capital and export credit. Tax cuts can ease working capital constraints. Many countries have promoted exports by cutting tax related to export production, or by offering tax rebates and duty drawbacks. Some infrastructure spending has targeted SMEs by allocating public contracts to SMEs through small tenders and projects dedicated to SMEs, allocating a specific percentage of contracts for SMEs, and giving preference to SMEs with high employment intensity.

IV. The contribution of the international trading system to productive capacity and employment creation

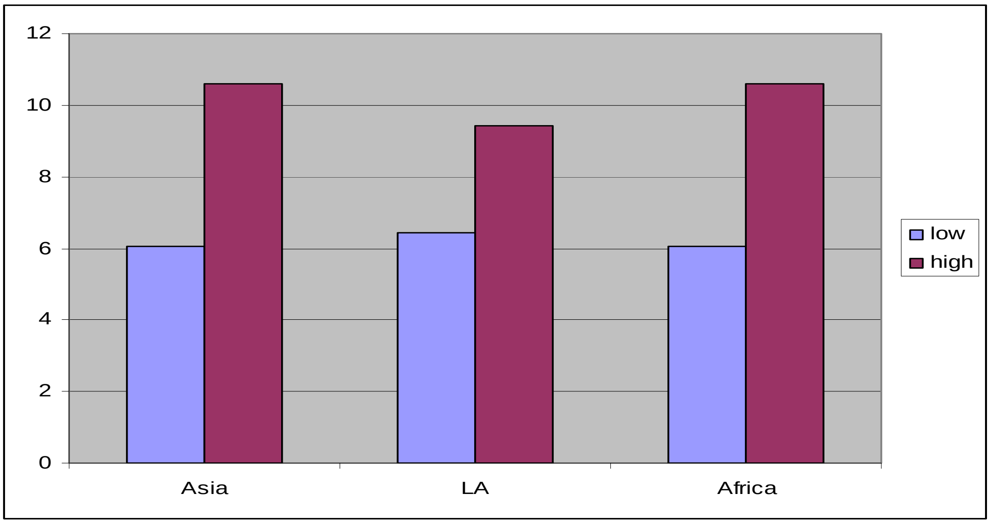
41. The comprehensive and proactive stance taken on trade and industrial policies in new-generation longer-term development strategies has blurred the distinction between industrial, trade and labour market policies. One important implication of this is the increasing relevance of the ITS and of policy space to countries’ growth strategies. Productive capacity and employment considerations feature prominently as an overarching objective of trade agreements. The preamble to the WTO Agreement recognizes that its members’ trade relations “should be conducted with a view to raising standards of living, ensuring full employment […], and expanding production of and trade in goods and services […].”Despite such recognition, the ITS has historically focused predominantly on trade liberalization, and has often failed to fully take into account its implications for productive capabilities, employment and development.

42. While various labour market policies are not subject to trade disciplines as such, the ITS can affect the ability of countries to implement certain proactive policies. The ongoing Doha Round and regional processes are affecting various dimensions interfacing trade, employment and industrial development. In order for the ITS to be supportive of achieving its objective of promoting full employment, there is a need to review its conventional focus on trade liberalization and to align liberalization approaches and disciplines to broader development objectives.

A. Enhanced market access to boost labour demand in the export sector

43. The ITS can contribute to boosting labour demand and expanding production in the export sector by enabling countries to reduce tariffs and non-tariff barriers (NTBs) in export markets and by providing significantly enhanced market access and entry for developing countries. Relatively high tariffs are applied on labour-intensive goods and lower tariffs on the least labour-intensive products, including minerals (fig. 12). Reducing these high tariffs would, firstly, create employment, especially for low-skilled workers, and secondly, allow for diversification into labour-intensive manufactures and away from primary commodities. Higher tariffs on labour-intensive goods discourage such diversification efforts, similar to the tariff escalation that hinders exports of higher value-added goods.

Figure 12. Average tariffs faced by low and high labour-intensive exports from developing countries



Source: UNCTAD, based on GTAP.

44. The Doha Round can enhance market access opportunities for developing countries in labour-intensive, value-added dynamic products if those products of export interest to developing countries are covered by deep tariff cuts. A harmonizing Swiss formula in NAMA reduces tariff dispersion by reducing higher tariffs to a greater extent, although it also induces deep tariff cuts in developing countries and risks de-industrialization, hence the need for LTFR (table 2). For countries dependent on preferences, preference erosion could adversely affect their competitiveness while those not benefiting from preferences gain from MFN reduction. Since a tariff-cutting formula for agriculture would not reduce high tariffs as much as the Swiss formula, the existing tariff dispersion would largely remain across agricultural products and between agricultural and industrial products, and the level of cuts could be further limited by exceptions, including for "sensitive" products. While reducing agricultural subsidies could expand developing-country agricultural output and employment, the magnitude of effective subsidy reduction may be limited owing to the presence of binding "overhangs" and "box shifting" practices. Liberalization of labour-intensive services through Mode 4 could also facilitate employment creation and generate estimated gains of over $150 billion.

Table 2. NAMA Swiss formula tariff cuts

		Initial bound	New bound	Percentage cut
EU	Total NAMA	*4.0*	*2.1*	*26.6*
	Apparel	*11.6*	*4.7*	*59.5*
United States	Total NAMA	*4.0*	*1.9*	*24.5*
	Apparel	*10.8*	*4.0*	*63.0*
Brazil	Total NAMA	*29.8*	*13.3*	*53.3*
China	Total NAMA	*9.0*	*6.1*	*24.3*
India	Total NAMA	*39.3*	*15.1*	*60.4*
South Africa	Total NAMA	*18.1*	*9.8*	*39.1*

Source: UNCTAD and WTO.

45. Addressing NTBs could provide an additional impetus, as the incidence of NTBs can be more significant than that of tariffs (table 3). Smaller countries and SMEs are disproportionately affected, as they often incur a fixed cost element. Eliminating excessive requirements and facilitating exporters to meet regulations could significantly improve

market entry. Since NTBs are not addressed in agriculture, and NAMA negotiations on NTBs focus on technical barriers to trade (TBT)-related sector-specific barriers mainly on higher-end manufactures, the direct commercial effects on developing countries are yet to be ascertained. RTAs could usefully address NTBs through deeper regulatory cooperation (e.g. mutual recognition) and support for building standards-related capacities.

Table 3. Ad valorem equivalent of non-tariff measures and tariffs (percentages)

	All		Agriculture		Manufacturing	
	OTRI	TTRI	OTRI	TTRI	OTRI	TTRI
European Union	*8.9*	*4.3*	*55.9*	*21.6*	*4.1*	*2.6*
Japan	*9.0*	*3.8*	*50.1*	*26.1*	*4.1*	*1.2*
United States	*6.5*	*2.1*	*20.0*	*3.7*	*5.3*	*2.0*
Brazil	*21.9*	*9.7*	*26.6*	*8.1*	*21.5*	*9.8*
China	*9.5*	*4.9*	*17.2*	*9.6*	*9.0*	*4.6*
India	*15.4*	*9.2*	*50.0*	*33.5*	*14.5*	*8.6*
South Africa	*5.1*	*4.5*	*14.0*	*8.1*	*4.6*	*4.3*

Source: UNCTAD, based on World Bank.

Note: OTRI: Overall trade restrictiveness index; TTRI: Tariff trade restrictiveness index.

46. South–South regional integration could expand export opportunities in labour-intensive diversification goods and services, as regional integration can address deeper regulatory cooperation and trade facilitation, which significantly reduce trade costs. African efforts towards an African Common Market would be promising in facilitating structural change. This calls for "developmental integration" combining trade liberalization with regulatory cooperation, infrastructure, institutional and supply capacity-building.[19]

Box 6. Towards developmental integration in Africa

Despite the current low level of intra-African trade (10 per cent), GTAP analysis shows that deeper regional integration could boost growth, intraregional trade, employment and structural change. Assuming a 50 per cent reduction in intra-African tariffs, and also in NTBs (which often result from infrastructure deficiencies), simulation results show that African countries would trade more with each other and import less from outside. Due to the positive impact on income in Africa, in the longer term Africa's integration would also benefit non-African countries. Africa's welfare would increase by $6.5 billion.

	GDP change in %	Employment, unskilled, change in %	Exports, change in %
North Africa	0.26	0.66	1.72
ECOWAS	1.93	4.78	7.04
East and Central Africa	0.29	0.07	3.19
SADC	0.74	2.04	3.12

Source: UNCTAD.

[19] UNCTAD and the African Union (2010). Trade liberalization, investment and economic integration in African RECs towards the African Common Market (forthcoming).

Regional integration would also support structural change. More efficient use of resources and larger markets would create a better chance for industries to exploit economies of scale and to increase their productivity. Output in textiles and manufacturing would increase. Employment would increase in all African regions, especially in the ECOWAS countries and the SADC countries.

B. Strategic liberalization tailored to developmental and labour market conditions

47. Tariffs could be an effective instrument for industrial and employment policy. Carefully designed content, depth, pace and sequencing of liberalization approaches, tailored to developmental and labour market conditions, is key to pre-empting de-industrialization and creating endogenous productive capabilities. A viable local production base was essential in success stories of export-led growth strategies. A strategic approach to liberalization can also limit the severity of labour market adjustment and job losses, especially where import-competing industries exhibit high labour intensity. This is particularly important as higher adjustment costs, implied by the weakness in social safety nets and a large informal sector, place many developing countries at a considerable disadvantage in managing market opening.

48. Studies on employment effects of the Doha Round find considerable cross-sector labour movement, implying high adjustment costs. The Carnegie Endowment estimates that the three poorest countries/regions in its simulation (Bangladesh, East Africa and Sub-Saharan Africa) would lose unskilled jobs in manufacturing industries, partly compensated by increase in agricultural jobs. UNCTAD’s GTAP analysis finds an overall positive impact on unskilled employment in most regions, but many developing countries lose employment in industrial sectors, compensated by employment growth in agriculture (table 4). Some countries may lose in total unskilled employment, including Brazil (plus four additional regions in the Carnegie Endowment’s simulation). Despite global net welfare gains, output, employment and wages could decrease in the industrial sector in favour of agriculture. The results point to a case for strategic and gradual liberalization, particularly to attenuate job losses in the industrial sector. While lowering the level of tariff cuts amounts to limiting welfare gains, such opportunity costs might be justified for the longer-term sustainability of liberalization.

Table 4. Employment effects of the Doha Round

Region	**Textiles**	**Motor vehicles**	**Manufactures**	**Total**
United States	*-2.30*	*-0.22*	*0.07*	-
European Union	*-1.00*	*0.13*	*0.35*	-
Japan	*-0.67*	*1.98*	*0.38*	-
China	*2.10*	*-0.28*	*-0.04*	*0.31*
India	*2.96*	*0.89*	*1.27*	*0.79*
Brazil	*-2.10*	*-3.01*	*-2.97*	*-0.21*
South and South-East Asia	*3.65*	*1.43*	*0.84*	*1.01*
Latin America	*-1.18*	*-0.59*	*-0.87*	*0.25*
Central and Eastern Europe	*-1.36*	*-0.01*	*0.34*	*0.20*
North Africa and Middle East	*1.10*	*0.62*	*1.78*	*0.95*
Sub-Saharan Africa	*-0.96*	*0.84*	*1.05*	*0.49*

Source: UNCTAD simulation using GTAP 7.

49. Gradual liberalization is a central principle of WTO, and is embodied in the SDT and LTFR principles for developing countries. The Doha mandate on strengthening SDT

and making it more precise, effective and operational is yet to be delivered. Translating LTFR into the concrete parameters of the Swiss formula has been a key negotiating issue in NAMA, especially in view of the increased importance attached to sectorals. The issue arose because developing countries will generally be undertaking deeper cuts in bound tariffs than developed countries, although their applied rates will be reduced to a smaller extent due to tariff water. For agriculture, tariffs are often the only means in developing countries to protect small-scale farmers, who represent a large share of employment. Increased scope for tariff protection under special products and contingent SSM in case of unsustainable import surges would provide developing countries with effective instruments to protect labour-intensive small-scale farming. Developing countries engaged in North–South RTAs could face challenges, as the LTFR principle could be overridden by the reciprocity requirement of GATT Article XXIV to liberalize "substantially all the trade", which points to a case for reforming that article to allow for LTFR in RTA context as well. Furthermore, the scope of RTAs (especially North–South RTAs) has become deeper and broader, with WTO-plus commitments. The extended scope and depth increases the costs of adjustment, and limits policy and regulatory flexibility to undertake proactive developmental policies.

C. Strengthened cooperation to help implement national accompanying measures

50. Realizing net welfare gains from trade liberalization requires social safety nets and adjustment mechanisms. While developing countries' capacities to implement such measures are highly constrained, such differences are often taken as given in trade policy debate, and an unambiguous case for freer trade tends to be emphasized. This calls for adapting liberalization approaches to countries' capacity to manage and mitigate labour market adjustment costs and provide support for developing countries to implement the required accompanying measures, so that the speed of job destruction does not outstrip that of job creation. This marks a sharp contrast with the valuable role played by trade adjustment support programmes in developed countries, such as the Trade Adjustment Assistance programme (United States), and the European Globalization Adjustment Fund.

51. The Doha Round has given greater attention to capacity constraints faced by developing countries with the formalization of Aid for Trade, and the development dimension has become an agenda in regional trade negotiations, especially in North–South contexts. Strong and expanded aid for productive capacity, employment and trade could be linked to trade liberalization commitments to help developing countries implement accompanying domestic measures, including labour market adjustment.

V. Conclusion

52. Trade-led growth remains key to developing countries' growth and development in the post-crisis period. To maximize beneficial effects from trade for development, countries have adopted comprehensive and proactive approaches, with productive capability formation and employment creation defined as two major objectives. In pursuit of these objectives, trade-related policies and industrial policies are mobilized simultaneously. This new development orientation has the potential to foster inclusive growth and development. The ITS is increasingly relevant to employment creation, as labour demand–creating policies are trade-related, and labour market policies are essential for facilitating labour market adjustment. The evolution of the ITS and its various facets – multilateral, regional and bilateral – critically need to factor in this new development orientation and employment-creation concerns. The MTS remains a central pillar of the ITS, and the Doha

Round needs to be concluded this year with a strong development content. Particular attention should be given to redesigning the ITS, to enlarge its focus beyond liberalization, and to include broader development orientation based on supporting productive capacity and job creation and on contributing to addressing global and multiple crises.