

## TRADE EXPANSION, EMPLOYMENT AND COUNTRY SELECTIVITY

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This note reflects work which has been proceeding in the IDS on the potential impact of trade liberalization in developed countries on unemployment and poverty in developing countries, (Singer *et al.*). This work is set in the context of the general concern of the Institute with problems of employment and income distribution in poor countries. Our interest has therefore been less in the overall benefits from trade than in the distribution of those benefits — that is, the degree to which increased export opportunities could help to relieve poverty and unemployment in all developing countries, and could be of particular assistance to the poorest and least-developed countries. The work has two principal elements: first, the construction of a framework for analysing the impact of trade liberalization, and second, the implications of such an analysis for a poverty and unemployment-oriented trade liberalization policy in developed countries.

Traditional trade theory argues that the benefit of trade liberalization to exporters is that it increases their export earnings. It does so in two ways:

- (a) it can raise the price received by exporters for their existing exports. This will normally be the immediate effect of tariff preferences or reductions in the general levels of import duty; the level of increase depending on the relative supply and demand elasticity in the exporting and importing countries;
- (b) it can lead to an increase in the quantity of exports.

In the short run (when productive capacity in the exporting country may be assumed to be fixed) it can bring unused capacity into production. In the long run, it can lead to investment in the export industry and a consequent increase in export capacity. The extent to which this happens will depend on the long-term elasticity of supply

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of the export and the duration and certainty of the liberalization measure in question. Short duration or uncertainty (e.g. variable quotas or escape clauses) may inhibit the investment required to increase export capacity, and will thus lessen total benefit.

This benefit is achieved at some cost in the exporting country. The extent of this cost will depend on the level of unused resources in the country – i.e. the scope for vent from surplus.

In so far as countries tend to export goods which are intensive in locally plentiful factors of production, the neo-classical theory would argue that an increase in exports from poor countries, where labour is plentiful and capital scarce, would tend to favour labour-intensive industries and would thus be particularly beneficial for employment. Since labour is less productive in poor countries than in rich countries (being combined with smaller average capital inputs) an increase in exports from poor countries which replace domestic production in rich countries will create more direct jobs in the exporting country than are lost in the importing country.

The most recent empirical study in this area is that carried out for the ILO by Lydall, who distinguishes four effects on employment of increased exports (his work is confined to manufacturers and processed products).

These are:

- (a) the direct effects on employment in the exporting and importing countries. These are the additional people employed in the export industry and the fall in employment in the industry in the importing country;
- (b) inter-industry or linkage effects on employment in the exporting country. These are the additional jobs created in industries producing direct or indirect inputs for the export industry, and are estimated by the use of input-output tables;
- (c) multiplier effects on employment resulting from the additional domestic expenditure generated by incomes in the export industry. These are calculated by Lydall from data on import propensities;
- (d) expenditure effects, or the impact on employment in developed

countries of increased developing country imports resulting from these increased exports. It is assumed that all the additional export earnings are spent directly or indirectly on imports from the developed countries.<sup>1</sup>

This model is necessarily simplified, and many factors which are not easily susceptible to cross-country analysis have been ignored. But on the basis of his framework, Lydall's conclusions tend to confirm the presumptions of the neo-classical approach. Generally, the poorer the country, the more jobs are created for a given quantum of increased exports. Thus, whereas over ten jobs will be directly created in a country with an average per capita income of \$100 for each additional \$10,000 of value added in industry, under three jobs will be created by a similar increase in industrial exports in a country with an average per capita income of \$1,000. The actual number of jobs created will of course vary from industry to industry, and the variation between the labour requirements of labour and capital intensive industries will be larger in poor than in rich countries. Thus whereas the ratio of additional employment created by a quantum of exports in labour and capital intensive industries in a country with an average per capita income of \$1,000 is 2.4:1, the ratio in a country with an average per capita income of \$100 is 3:1. But these proportionate comparisons understate the differences. In absolute terms, the difference between the employment created by labour and capital intensive industries is 4.5 times as great in the \$100 per annum country as in the \$1,000 per annum country. Thus measures designed to increase exports of labour-intensive products are likely to have most direct impact on employment in the poorest countries.

Similarly, Lydall's estimates not only confirm that the direct loss of jobs in importing countries as a result of trade liberalization is far smaller than the number of jobs directly created in the exporting countries, but also suggest that, when the secondary effects on developed countries' exports are taken into account, there can, at least in respect of some industries be a net increase in the total level

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<sup>1</sup>With the increases in oil prices, this assumption appears less plausible. For countries where oil will account for a high percentage of expenditure on imports, much of any additional export earnings may end up as additions to the reserves of oil producing countries.

of employment. It is misleading to consider trade liberalization by rich countries as in some sense a 'concession'; rich and poor countries are playing a non-zero sum game, in which both may benefit as a result of more liberal import policies in the developed world.

We may use calculations of this kind to make a rough estimate of the total potential impact of trade liberalization on employment in developing countries. Thus, between 1955 and 1970, the less developed countries' share in world trade fell from 25.3 per cent to 17.6 per cent. If the 1970 share had been the same as the 1955 share, developing country exports would have been 43 per cent greater. On very rough assumptions, such an additional level of exports would have given rise, both directly and indirectly, to employment equivalent to some 15 per cent of the labour force in less developed countries other than China (Tyler). If, as Singer estimates, unemployment in developing countries averages some 20-25 per cent of the labour force, such an increase in exports would make a very substantial impact on unemployment in the Third World.

All this is consistent with the neo-classical view of world trade. Its weakness lies in its omission of social, political and institutional factors which profoundly affect the distribution of benefits from trade. The only qualifying factor which Lydall, for example, takes into account is income per head in the countries concerned. But there are many other complicating and modifying elements which need to be brought into the calculations:

- (a) if production and trade are under the control of multinational companies with a narrow range of activities, both linkage and multiplier effects may be very weak. Linkages may be primarily with activities elsewhere in the corporation's network. Since much of the export revenue may be exported in the form of profits, dividends, service payments and management charges, the local multiplier impact will be weak. Moreover, the input-output type of analysis is static; it does not take into consideration the longer term impact on employment. This will depend on the level and disposition of the surplus derived from export production. If the surplus is channelled abroad, the long-term effects on employment may be very feeble;
- (b) if the local social structure and political system operate in such a

way as to encourage a high degree of inequality, the benefit of export industries to the poor will be very limited. Moreover, such inequalities may involve both a high demand for imports and the leakage abroad of much of the surplus accruing from export industries. Similarly, government policies in many areas such as taxation, education and technology will substantially influence the direct and indirect effects of export industries;

- (c) if export industries develop at the expense of industries which previously served the domestic market, there could well be a net loss of jobs. The export industry, designed to meet foreign demand for standardised products, might both use more capital intensive methods than industries for the home market and draw to a greater extent on foreign inputs.

Thus, although the neo-classical approach suggests the potential benefits to employment and poverty relief accruing from the expansion of trade, the degree to which these benefits are actually realized will depend on institutional, political and social factors which are outside its range. This has important policy implications. If developed country governments wish to liberalize trade in ways which will provide most benefit for employment and the relief of poverty, they will necessarily give first priority to labour-intensive products (although these are normally 'sensitive' industries in the importing countries, which exert pressure for protective policies). But beyond this, there may be an argument for trade liberalization to be confined to products originating in countries where the social, political and institutional framework is such that there is a fair presumption that poverty will be relieved and employment created. Country selectivity in trading arrangements is not new. For a mixture of political and commercial motives, trading blocs such as the Commonwealth Preference area and the countries of the Yaoundé Convention have provided selective access to developed country markets. When the Yaoundé Convention is revised as a result of Britain's admission to the EEC, it will still be a highly selective arrangement. Many of the poorest countries such as India, Pakistan, Bangladesh and Indonesia will not be covered by it. It could be argued that a system of selectivity based on criteria of employment creation and poverty relief would be an improvement over the existing commercially and politically motivated selectivity.

But such country selectivity may create more difficulties than it solves. First, the selection of 'desirable' beneficiaries involves the importing countries in sitting in judgment on the exporting countries. Such judgments will involve similar types of consideration to those which govern present country selectivity, and will certainly be regarded by the developing countries as colonialism under another name.

Moreover, country selectivity weakens the bargaining power of the developing countries in trade negotiations. UNCTAD studies have shown that poor countries are likely to receive far fewer concessions than rich countries in international trade bargaining (such as under the Kennedy Round). This is partly a reflection of the arrangements governing such negotiations. But it is also a result of the weak bargaining position of the developing countries. Such negotiations typically involve the striking of bargains between powerful industrial countries and groups of countries, in which concessions are made on products of mutual interest. Concessions are likely to be far fewer on products of little interest to the developed countries. The principal potential bargaining counter that developing countries could have in such circumstances would be their adoption of a joint negotiating position. But the effect of selective liberalization — whether on the lines of the existing preferential areas or in the form of supposedly poverty-oriented trade policies — is to create differences of interest between groups of developing countries, and to render even less probable the chances of any joint strategy for trade concessions from the developed countries. Thus such liberalization might in practice be another form of colonialism and a means of maintaining the supremacy of the already industrialized countries.

Lastly, country selectivity must vary over time, if only because governments and social systems change. A government whose policies help the poor may be overthrown. Of course changes of government in developing countries have frequently led to changes in developed country trade policies. United States policy towards Cuba is an obvious example. But, apart from the disadvantages of such changeable trade regimes (to which I shall return later), the advocacy of country-selective trade policies for what appear to be progressive ends may merely serve to give an air of respectability to similarly selective trade policies undertaken for quite different purposes.

Country selectivity could be understood in a narrower sense. Thus trade liberalization could be applied specifically to the poorest and least developed countries. However, such selectivity would involve first, a difficult (and highly political) task in identifying the countries who would receive the benefits of such liberalization, and secondly, discrimination against the other developing countries. Both the neo-classical theory and Lydall's work would imply that the liberalization of imports of labour-intensive products would be most employment-creating in the poorest countries, if they are in a position to expand their exports. But the growth in export capability will depend less on market access as such than on the supply of relevant know-how, the adaptation of institutions and the transformation of local economies. Thus the selective application of trade liberalization to the poorest countries might in any event be ineffective in stimulating employment-creating exports.

Although our approach would suggest that there is no certainty about the employment stimulating effects of trade liberalization measures, the attempt to cope with this problem through systems of country-selective trade concessions has severe disadvantages. If this view is accepted, it follows that there is no way of directly matching trade liberalization measures with the creation of employment in developing countries. All that trade liberalization can do is to create the possibility of more effective poverty and unemployment policies inside developing countries. It cannot of itself ensure that such policies will be formulated or implemented.

But this does not mean that there are no criteria which can be applied to trade liberalization measures so as to increase their relevance to employment creation programmes. The following are some obvious considerations:

(a) **Products.** We have already argued that first priority should be given to the liberalization of trade in agricultural products and labour-intensive manufactures (including craft products). Unfortunately it is in this area that trade liberalization encounters most opposition in developed countries. The farm lobby in the EEC and the political influence of manufacturers of labour intensive products are two well-known examples. As Hans Singer has said, the export of labour-intensive products from

developing countries attracts restrictions as a jam-pot attracts wasps. Such a liberalization policy is therefore inseparable from effective adjustment assistance and regional policies inside developed countries.

- (b) **Foreign Exchange.** The increase in oil prices has served to highlight the balance of payments constraints governing employment policy in many developing countries. In some of the poorest countries, the most immediate prospects for increasing foreign exchange earnings lie in the processing of their own raw materials or agricultural products. The lowering of rates of effective protection on such industries in developed countries could therefore be of special help in this area.
- (c) **Duration and Certainty.** The benefits of trade liberalization take time to work themselves out. This is especially so in the poorest exporting countries. But in all countries any sizeable increase in exports will involve new investment in the export industry, and this will be deterred if trade liberalization measures are of short duration or uncertain application (e.g. through variable quotas).

We have argued that a neo-classical analysis of the impact of exports on employment is inadequate. But the policy measures which we suggest for developed country liberalization policies are in fact indistinguishable from those suggested by neo-classical economists (see e.g. Johnson). This conclusion may appear paradoxical. What it implies is that, in so far as social, institutional and political structures inside developing countries stand in the way of an ideal pattern of income distribution or employment creation, this can be remedied only by the people of the exporting country itself. If these constraints reflect the working of a world system of concentration of power within a few multinational corporations, developed country policies which do nothing about the structure but which attempt, within this framework, to favour those countries which appear best to surmount the constraints, appear doomed to failure. Any selective trade policy, however well-intentioned, will be caught up in the system and will merely serve in the end to aid the interests of the existing power structure.

What lines of work does this approach suggest? A clear conclusion is that we need to know far more about the impact of institutional



arrangements in production and trade. What is the differential short and long run impact on employment of, for example, export crops produced by peasants and those produced by plantations? And what difference does it make if the plantations are owned predominantly by nationals (as in Mauritius) or by foreign companies? Or again, what is the relative impact on employment of different patterns of industrial exports — e.g. through multinational corporations (runaway industries) or through national capitalists or public enterprise? A wide range of alternative arrangements in production and trade could be examined from this point of view.

The Lydall method offers a useful first approach, but it needs to be extended. First, different institutional arrangements will affect the distribution of the benefits from trade between exporters and importers. Secondly, if we are concerned with the long run impact of exports on employment, we need to know how much surplus is produced in the export industry, who controls its distribution and use, and what is its final disposition. Lastly, we must treat linkage effects in a rather broader context than the input-output framework. Do different styles of organization have different impacts on the development of local skills or technology? These may be the most important long-run benefits of exports to the relief of poverty and unemployment.

### References

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