

IOE Position Paper on Understanding Trade



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Contents

- Executive Summary 3
- Introduction..... 5
- Context: Trade developments..... 7
 - 1. Increasing fragmentation of production processes 8
 - 2. Trade in services is increasing 9
 - 3. Trade agreements are expanding bilaterally and regionally..... 10
 - 4. The increasing scope of trade agreements to include sustainability (labour, environment, political participation, transparency) and investment provisions 11
- Understanding trade: distinguishing facts from perceptions 14
 - 1. Balance of trade is not an accurate portrayal of the gains of trade 14
 - 2. The disadvantages of trade tend to be exaggerated and misleading 17
 - 3. Trade liberalization has significant positive impacts on the economy which are often neglected 18
- Policy Recommendations 21
 - Domestic policies..... 21
 - Inclusive growth policies 21
 - Structural policies..... 22
 - Compensatory policies 23
 - International policies..... 24
 - Trade liberalization..... 24
 - International trade agreements and labour provisions 26
- Call for action to national EBMOs 28



Executive Summary

Trade and market openness have historically gone hand-in-hand with better economic performance in countries at different levels of development. Despite the positive correlation between trade and economic growth and efforts to promote trade openness, political rhetoric and trade developments have been less than positive. Global trade has been slowing down since 2012 and with recent trade tensions notably between the United States and China, increasing trade restrictions and the onset of the COVID-19 pandemic, global trade has been predicted to slow down even further in 2020-2021.

Much of the reason behind the trade tensions and increased trade restrictions has to do with the negative rhetoric surrounding trade. This IOE paper attempts to address the negative rhetoric surrounding trade in light of recent trade developments. By debunking popular trade myths, this paper seeks to provide IOE members with the right arguments to push for appropriate trade liberalization efforts backed by empirics rather than misperceptions and relevant policy recommendations.

Trade openness, is a positive phenomenon, resulting in better economic performance in countries at different levels of development, creating new opportunities for individuals, consumers and firms and helping to lift millions of individuals out of poverty. However, it must also be recognized that the benefits of trade are not always equitably and immediately distributed. Perceived negative economic outcomes such as job destruction, particularly for developing countries, are often not a result of trade liberalization itself, but rather due to larger economic developments such as changes in productivity and demand.

The impact of global trade on people depends both on national policy settings of the countries in which they live and on the nature and degree of international economic cooperation. In order for the gains of trade to be maximized and equitably distributed, governments need to act across many fronts simultaneously. This implies working across silos and taking a much more integrated policy approach,

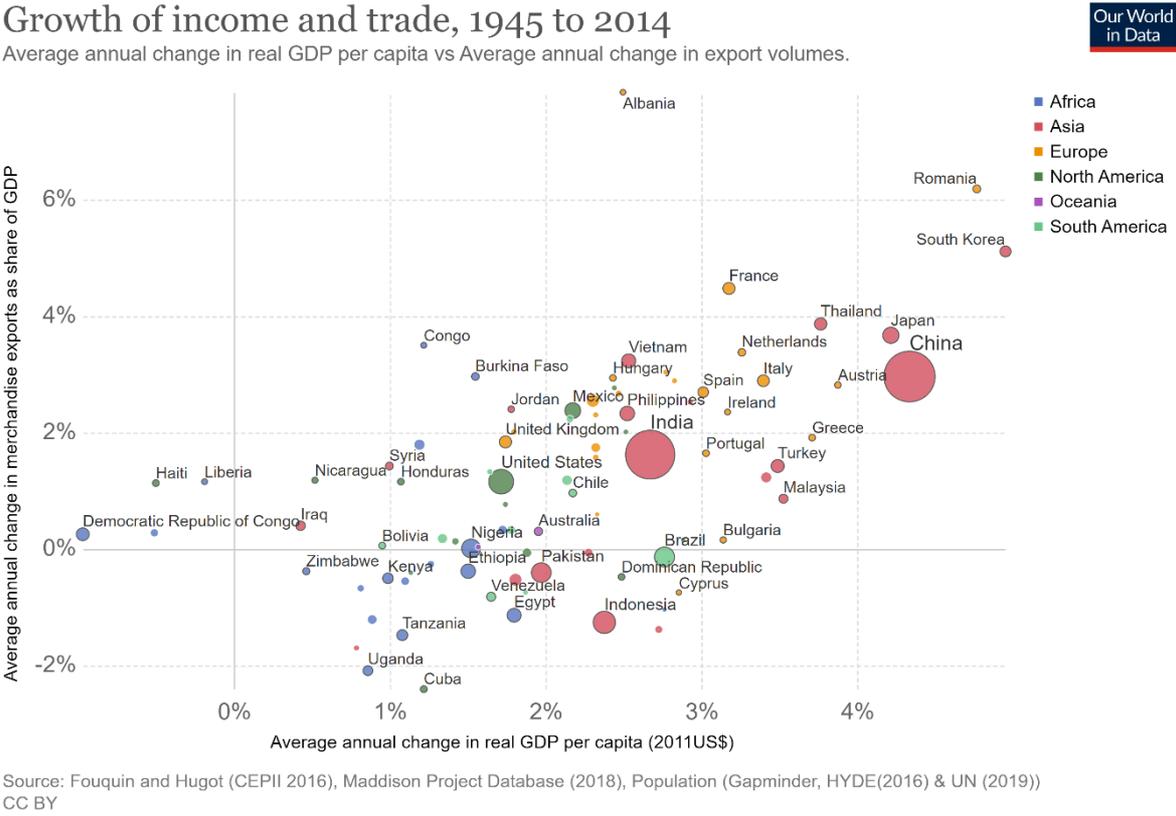
both domestically and internationally. Domestically, this means that proper infrastructure needs to be in place, strong institutions need to be present and rigidities in labour markets, financial markets and regulations need to be tackled. At the micro level, it is also pertinent for individuals to change their mindsets and be open to reskilling and upgrading themselves in today's changing world of work. Inclusive growth policies such as retraining and investing in productivity and competitiveness as well as ensuring better access for all to health services, social protection and education will need to be considered. On the international front, international cooperation in trade liberalization efforts is necessary.

These policy recommendations are even more essential today in light of the recent COVID-19 pandemic. Due to the spread of the virus, governments have been forced to take strict measures such as closing down borders in order to protect people's lives. These measures inevitably will have painful consequences for households and businesses. To mitigate the economic damage of the crisis, policymakers will need to lay the right foundations for a strong, sustained and socially inclusive recovery. Trade will be an important part of that solution. Keeping markets open and predictable as well as fostering a more generally favorable business environment will be critical to spurring the renewed investment needed to rebound the global economy and mitigate the huge impact on employment. This would include counteracting protectionist measures that have been adopted before and during the pandemic. Likewise, multilateral cooperation across countries is crucial in ensuring a speedier recovery than if each country acts alone.

Businesses and trade have always been closely connected. As such, business has an important stake in contributing to trade policies which lie at the heart of ensuring the sustainable and inclusive economic growth and societal progress that enterprises require to establish and prosper, thus creating jobs and wealth. However, in order to achieve better economic outcomes resulting from trade liberalization efforts, business cannot and should not be expected to work alone.

Introduction

Trade and market openness have historically gone hand-in-hand with better economic performance in countries at different levels of development¹. By plotting GDP growth and growth in trade, the chart below shows a correlation between economic growth and trade² around the globe from the last century, indicating that countries with higher rates of GDP growth tend to have higher rates of growth in trade as a share of GDP.



Despite the positive correlation between trade and economic growth and efforts to promote trade openness, political rhetoric and trade developments have been less than positive. UNCTAD's Statistics and Trends in International Trade report that international trade in the past few years was marked by an anemic growth between 2012 and 2014, followed by a downturn in years 2015 and 2016 and a

¹ World Trade Organisation (WTO), 2017, "Making Trade an Engine of Growth for All".
² Specifically, the graph uses exports as a variable for trade. Thus, the graph is interested in looking at how countries' ability to sell their product to other countries can have an impact on their GDP. Imports, on the other hand, are not taken into account here. Imports are also used as a proxy for trade. Imports refer to a country's purchase of foreign products – either for final consumption or to be used as an input to produce other products. In emerging countries, a rise in import growth may reflect periods of high investment and economic growth.

rebound in 2017 and 2018³. In particular, world merchandise trade grew by 3.0 percent in 2018, slightly exceeding GDP. This was significantly lower than the 4.6 percent growth recorded in 2017. With the outbreak of COVID-19 across the globe early this year, trade is further declined, with the WTO predicting further decrease in world trade between 13 and 39 percent this year⁴.

Putting aside the COVID-19 pandemic, two major factors propelling the slowdown in world trade are increasing trade tensions notably between the United States and China and historically high levels of trade restrictiveness. According to the WTO's 2019 trade monitoring report⁵, new restrictions implemented by WTO members continued at a historically high level between mid-October 2018 and mid-May 2019. In particular, the ongoing United States-China trade disputes has resulted in a sharp decline in bilateral trade in 2019 resulting in an overall slowdown of world trade⁶. Protectionist measures have stirred uncertainties in the world market and triggered a chain of measures and countermeasures.

The trade tensions that we are witnessing today are not especially new, rather they have been building up the past decade. While in developing economies, generally, trade is regarded positively as a source of growth, development and jobs, in some advanced economies, even where people support trade in principle, they have more mixed views about particular trade agreements and trading relationships. For instance, the challenging renegotiations surrounding the North American Free Trade Agreements (NAFTA) among the United States, Mexico and Canada is a recent example of how traditionally open and liberal economies are reviewing their trade relationships.

Trade openness, is a positive phenomenon, resulting in better economic performance in countries at different levels of development, creating new opportunities for individuals, consumers and firms and helping to lift millions of individuals out of poverty. However, it must also be recognized that the benefits of trade are not always equitably and immediately distributed. Perceived negative economic outcomes such as job destruction, particularly for developing countries, are often not a result of trade liberalization itself, but rather to larger economic developments such as changes in productivity and demand.

³ United Nations Conference on Trade and Development (UNCTAD), 2019, "Statistics and Trends in International Trade".

⁴ WTO, 2020, "Trade set to plunge as COVID-19 pandemic upends global economy", press release.

⁵ World Trade Organisation (WTO), 2019, "Report of the Trade Policy Review Body from the Director-General on Trade-Related Developments", Mid-October 2018 to Mid-May 2019 data.

⁶ UNCTAD, 2019, "Trade and Trade Diversion Effects of United States Tariffs on China".

Acknowledging that the impact of global trade on people depends both on national policy settings of the countries in which they live and on the nature and degree of international economic cooperation. In order for the gains of trade to be maximized and equitably distributed, governments need to act across many fronts simultaneously. This implies working across silos and taking a much more integrated policy approach, both domestically and internationally.

At least 80 countries have adopted export restrictions⁷ in response to COVID-19 crisis. These measures inevitably will have painful consequences for households and businesses. Basing trade liberalization efforts on facts rather than perceptions is even more crucial in light of the recent COVID-19 pandemic. Moreover, the closure of borders to prevent further spread of the disease, adds on trade development stress. To mitigate the economic damage of the crisis, policymakers will need to lay the right foundations for a strong, sustained and socially inclusive recovery. Trade will be an important part of that solution. Keeping markets open and predictable as well as fostering a more generally favorable business environment will be critical to spurring the renewed investment needed to rebound the global economy. In addition, multilateral cooperation across countries is crucial in ensuring a speedier recovery than if each country acts alone.

This IOE paper attempts to distinguish facts from perceptions so as to help better understand trade developments. In doing so, the paper also considers the challenges hindering trade from reaching its full potential, allowing IOE members to identify which of these challenges they may experience in their economies and look at some possible ways forward.

Context: Trade developments

The nature of trade has undergone vast evolutions throughout history. In the past, economies were closed off and focused primarily on producing and consuming their own products. As economies opened up, trade initially involved exchanging locally-produced goods. Over time, economies evolved to produce goods and services. Production of a good began to be fragmented as economies learnt to outsource production processes to other sectors or to other countries. These developments were subsequently reflected in trade itself as well as in trade agreements.

In general, trade developments take four main forms:

1. Production processes are increasingly fragmented;
2. Trade in services is seen to be increasing;
3. Trade agreements are increasingly negotiated bilaterally and regionally; and

⁷ https://www.wto.org/english/news_e/news20_e/rese_23apr20_e.htm

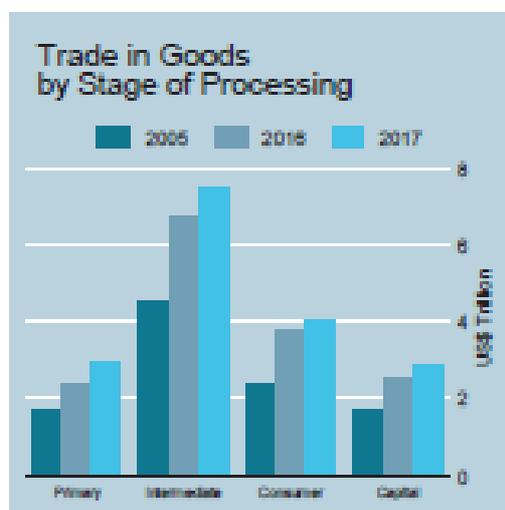
4. Trade agreements are increasing in scope to include sustainability (labour, environment, etc.) and investment provisions.

All these developments have changed the way trade and trade agreements are organized, resulting in positive and sometimes negative consequences.

Recognizing that the nature of trade has evolved in the above ways is an important first step in coming up with appropriate and sound trade liberalization efforts that can ensure that the gains of trade are maximized and equitably distributed among countries and within economies. Thinking of trade in terms of the past neglects the realistic nature of trade and further engenders negative misperceptions concerning trade.

1. Increasing fragmentation of production processes

In the past, trade between countries primarily consisted of exchanging finished products. However, this is no longer the case. In fact, trading of final goods and services represents only 30 percent of trade today. 70 percent of world trade is organized around global value chains which consist of trading in intermediates. The graph below shows that the growth of trade in terms of intermediate goods has been substantial since 2005.



Source: UNCTAD (2018)⁸

According to the Organisation for Economic Cooperation and Development (OECD)'s Trade in Value-Added (TIVA) database, an Apple iPhone assembled in China only retains 4 percent of the total value of the iPhone; the rest of its value is actually attributed to other countries that provide inputs all along the supply chain. Such complex global production arrangements have changed the nature of trade in

⁸ UNCTAD, 2018, "Key Statistics and Trends in International Trade".

many ways, although political rhetoric continues to describe trade between purely producers and demanders of a particular good.

Participation in global value chains has enabled many more countries to participate in global trade, with developing countries increasing their share of global exports and imports. For instance, economies like Vietnam, Thailand and Malaysia which have a high share of imported intermediates in their GDP have shown to benefit most from global value chains. However, not all countries gain the same way from participating in global value chains. For instance, research reports that upper-middle and high-income countries tend to benefit more from such participation than low and lower-middle income countries as these countries focus on producing high value-added products, which lead to the creation of high-income jobs⁹.

Institutions and structural barriers on trade are cited as obstacles that hinder low and low-middle income countries from benefitting more from participating in global value chains: inefficient or inadequate systems of infrastructure (in the form of transportation, logistics or customs), poor connectivity in telecommunications, financial markets or information technology and rigid regulatory environments that discourage investments, innovation and market growth. Such barriers to trade tend to raise the costs of trade for productive firms in these countries, hampering them from competing effectively in the global market¹⁰.

2. Trade in services is increasing

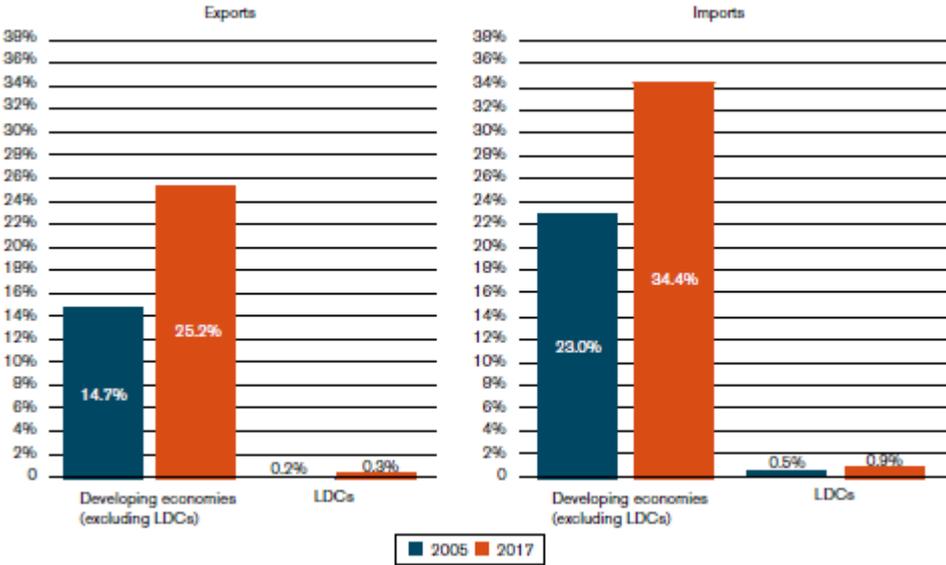
Other than participation in global value chains, another evolution in the nature of trade, misunderstood by many, is trade in services. Services trade has become an increasingly important component of global trade. Between 2005 and 2017, trade in services expanded faster than trade in goods, at 5.4 percent per year on average. Distribution and financial services are the services most traded globally, each accounting for one-fifth of trade in services. A common misperception is that developing economies are better able to produce goods than services at cheaper costs due to their reliance on labour rather than capital and hence they may be left behind by such developments¹¹. Though trade in services especially in intellectual property-related services is dominated by developed economies, the contribution of emerging economies to trade in services is increasing. The WTO reports that the contribution of emerging economies to trade in services grew by more than 10 percentage

⁹ OECD, 2018, "Market Opening, Growth and Employment", Trade Policy Papers, No.204.

¹⁰ World Bank Group, 2018, "Stronger Open Trade Policies Enable Economic Growth for All", Results Brief, <https://www.worldbank.org/en/results/2018/04/03/stronger-open-trade-policies-enables-economic-growth-for-all>.

¹¹ UNCTAD, 2014, "Trade in Services: A New Frontier for Developing Countries".

points between 2005 and 2017, indicating the increasing involvement of developing countries in services trade¹².



Source: WTO (2019)

Services are not only important inputs in manufacturing, but also constitute important after-sales activities such as training, maintenance, provision of spare parts for repairs services and a range of other customer care services¹³. In developed economies, due to a higher degree of servicification, services value-added accounted for 33 percent of manufacturing exports in 2015 compared to 29 percent in developing economies. While the aggregate services value in manufacturing exports remained stable for developed countries between 2005 and 2015, it increased in developing economies, notably in Asia, again attesting to the growing role of emerging economies to trade in services.

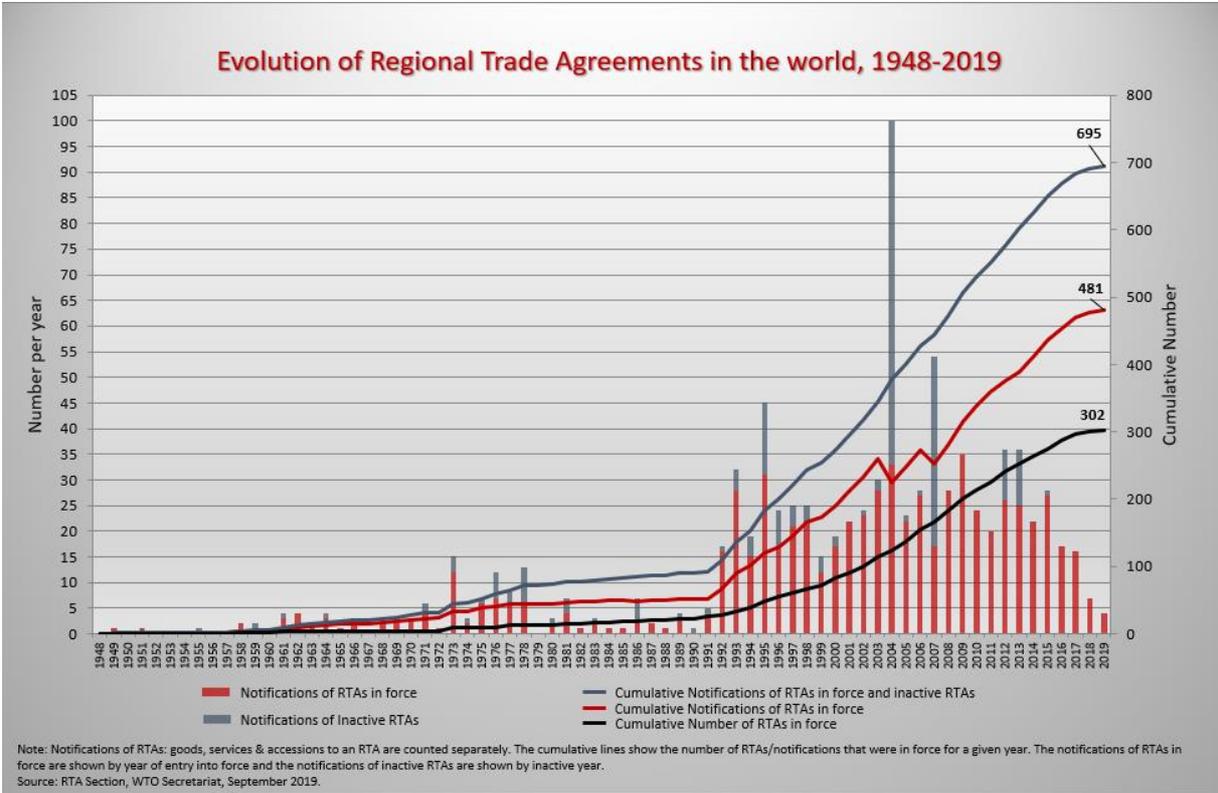
3. Trade agreements are expanding bilaterally and regionally

Another significant development in trade is seen in the type of trade agreements negotiated. Since the aftermath of World War II, the General Agreement on Tariffs and Trade (GATT) and subsequently the WTO established the rules for trade negotiations. Negotiations concluded within the WTO were often extended to all WTO members, thereby covering trade in over 160 countries.

¹² WTO, 2019, “World Trade Report 2019”.
¹³ Gaiardelli, P., Sacconi, N. and Songini, L., 2007, “Performance measurement systems in after-sales service: an integrated framework”, International Journal of Business Performance Management, Inderscience Enterprises Ltd, Vol 9(2), pg 145-171.

Increasingly, we notice many WTO members involved in negotiations creating new trade agreements, which are either bilateral or regional in nature. Such negotiations involving fewer parties tend to be easier to negotiate and the parties often choose to include provisions that go beyond existing WTO multilateral rules.

The WTO reports more than 290 regional trade agreements (RTAs) in force today with over 30 new agreements currently being negotiated¹⁴ such as negotiations in the Asia-Pacific Region for a Comprehensive and Progressive Trans-Pacific Partnership Agreement (CPTPP) which involves 11 parties and the Latin America effort to form the Pacific Alliance between Chile, Colombia, Mexico and Peru. Such agreements, once in force, have the potential to reduce the myriad of RTAs especially if they supersede existing bilateral agreements and develop common rules to be applied by all parties.



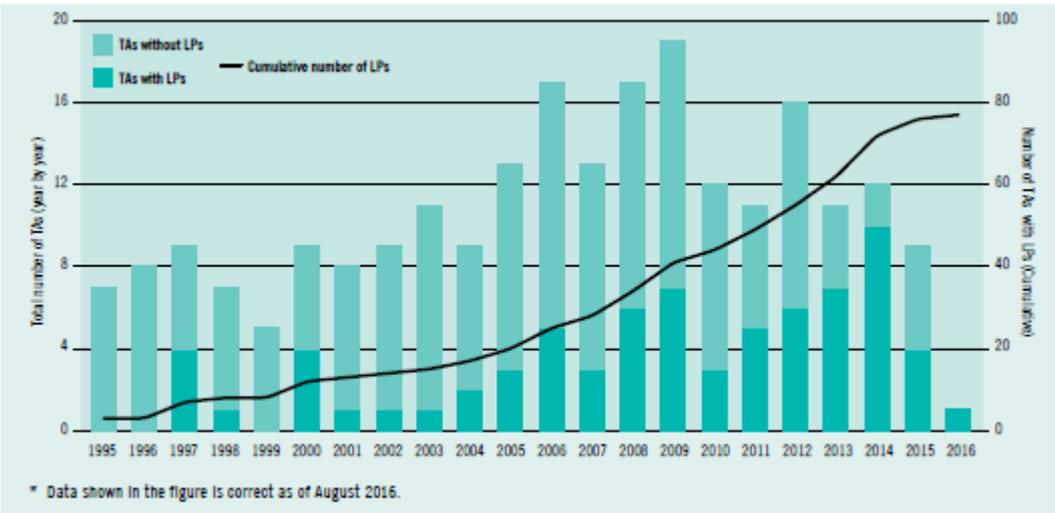
4. The increasing scope of trade agreements to include sustainability (labour, environment, political participation, transparency) and investment provisions

While RTAs operate alongside global multilateral agreements under the WTO, many are being developed in ways that go beyond existing WTO multilateral rules. Areas covered by many new RTAs include investment chapters (mainly pertaining to Foreign Direct Investments (FDIs)) and labour

¹⁴ WTO, 2018, Based on Regional Trade Agreements Information System.

provisions (which include fundamental labour rights and aspects of workers’ protection). It is also increasingly linked with other sustainability provisions, including clauses on environment, political participation, transparency, business conduct or consumer rights.

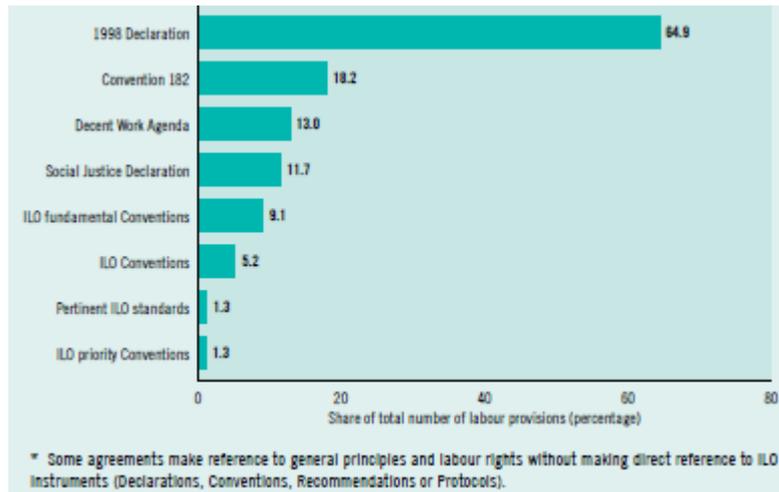
Over the last two decades, trade-related labour provisions have become more commonplace and comprehensive. According to the ILO, the number of trade agreements with labour provisions has increased from 3 in 1995 to 77 in 2016¹⁵. Additionally, since 2010 the share of trade agreements with labour provisions being concluded each year has increased. Consequently, the share of trade agreements with labour provisions has risen from 7.3 percent of the total number of trade agreements in 1995 to 28.8 percent in 2016.



Source: ILO (2017)

Additionally, labour provisions in trade have become increasingly comprehensive, with most referring to core labour standards, ILO Fundamental Conventions and other ILO instruments such as, among others, the 1998 Declaration on Fundamental Principles and Rights at Work (FPRW), as well as mechanisms for implementation and cooperation, including with stakeholder involvement. Where their scope is concerned, in some instances, parties commit themselves to these obligations under international frameworks relating to international labour standards on labour rights and principles. The figure below provides an illustration of the labour standards referenced in trade agreements as of 2016¹⁶.

¹⁵ International Labour Organisation (ILO), 2017, “Handbook on assessment of labour provisions in trade and investment arrangements”.
¹⁶ ILO, 2017, “Handbook on assessment of labour provisions in trade and investment arrangements”.



Source: ILO (2017)

While the intention to include such provisions is a positive one, labour provisions in trade agreements providing for economic sanctions and/or dispute settlement mechanisms directly impacting the private sector might be questionable. While countries agree that provisions aiming at the promotion to respect the FPRW have the potential to improve the labour market outcomes for their workers, the fear, on the part of low-income countries, is that these are used by advanced economies to withdraw legitimate trade concessions, leading to the deterioration of their market access¹⁷ or a deterioration of comparative advantage of low-income countries.

Moreover, the longstanding debate around the extensive interpretation by ILO supervisory bodies, puts some countries under pressure, due to their limited capacity to effectively implement questionable observations from the ILO Committee of Experts on the Application of Conventions and Recommendations, such as the ones related to Conventions 87 (Freedom of Association) and 98 (Collective Bargaining).

Regarding investment chapters, studies have shown the relevance of such provisions in today's trade agreements. According to the OECD, companies involved in international investment account for 55 percent of world trade. This overlap between trade and investment is a defining characteristic of global value chains, necessitating trade agreements to include investment provisions so as to address a broader set of policy issues that influence firms' strategies. Investment provisions typically offer protection to investors of one country investing in another country, thereby lowering non-commercial risk for such investors, and overall promoting a sound investment climate.

¹⁷ Bhagwati, J., 2001, "After Seattle: Free Trade and the WTO", *International Affairs* 77(1), Pg 15-29.

There is evidence that investment chapters in wider regional trade or economic partnership agreements actually have a larger impact on investment flows than bilateral investment treaties¹⁸. This could be attributed to the resulting economic and employment restructuring in economies adhering to the terms of these agreements¹⁹. Restructuring by strengthening the trade-related physical infrastructure in particularly low-income economies helps to create beneficial conditions for investors to liberalize, facilitate, promote and protect cross-border FDIs.

Overall, trade has evolved vastly throughout history. Ignoring these developments risks misunderstanding trade itself and creates negative perceptions of trade. Such perceptions if used to guide trade liberalization policies will end up hurting the very economies, people and businesses that these policies are intended to protect. The next section seeks to address three trade misperceptions in the context of these trade developments so as to provide empirically-backed policy recommendations to policymakers to truly realise the full potential of trade openness.

Understanding trade: distinguishing facts from perceptions

Perceptions matter, particularly in highly politicized debates such as trade liberalization. As a result of these misperceptions, many countries have been moving towards a policy of protectionism, as evidenced by increasing trade restrictiveness across countries. In important ways however, data and analysis challenge common perceptions about unfavorable trade agreements. Three common misperceptions concerning trade include taking the balance of trade as an outcome of trade, linking the negative economic aspects to solely trade and ignoring the positive aspects of trade. This section addresses these common misperceptions with facts in an attempt to provide a better understanding of trade liberalization.

1. Balance of trade is not an accurate portrayal of the gains of trade

The balance of trade measures the flow of exports and imports over a period of time. In other words, the balance of trade is the difference between what a country produces and what it buys from abroad. If a country exports a greater value than it imports, it is said to have a trade surplus and conversely, if a country imports a greater value than it exports, it is said to have a trade deficit. Other than indicating

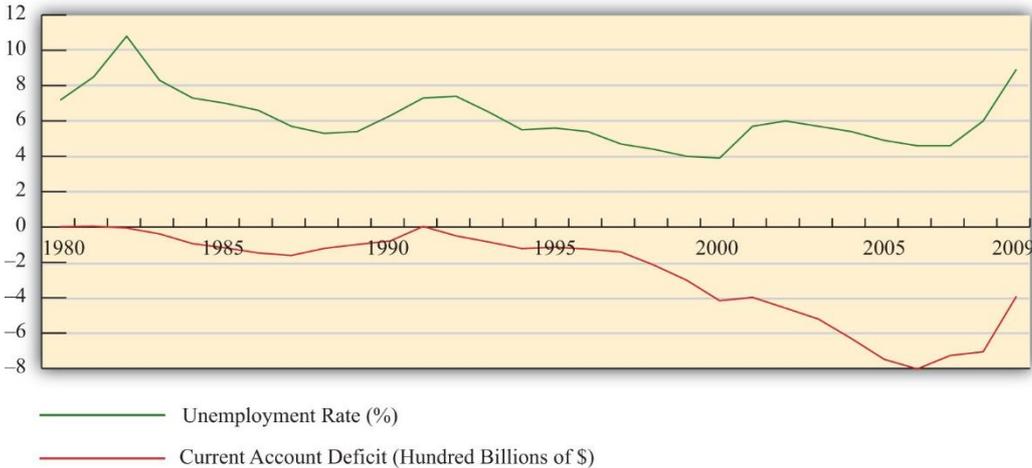
¹⁸ Leshner, M. and Miroudot, S., 2007, "The Economic Impact of Investment Provisions in Regional Trade Agreements", *Aussenwirtschaft*, Vol 62, Issue 02, pg 193-232.

¹⁹ United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), 2017, "Enhancing the Contribution of Preferential Trade Agreements to Inclusive and Equitable Trade".

the preferences of domestic consumers, the balance of trade does not convey good or bad trade outcomes.

Although trade surpluses are considered positive trade balances especially if resulting from a competitive economy and internationalized companies, they are not always necessarily a sign of strength in economies. In fact, persistent trade surpluses may indicate weak domestic demand, which, in turn, is a result of individuals choosing to save rather than consume. For instance, Germany and Japan are characterized by high savings rates and trade surpluses. Weak domestic demand may be a problem especially in post-crisis periods where it needs to be boosted to stimulate growth and employment²⁰ but it should also be recognized that it is the free choice of people to put off consumption, opting to save and sell goods abroad.

Conversely, while trade deficits are also known as negative trade balances, they may not necessarily be always a bad thing. Nevertheless, in America, a poll in March 2018²¹ showed that more than two-third Americans believe that the United States should reduce its trade deficit with China, even if it means that Americans may face higher consumer prices from the goods that they import. Some people believe that trade deficits cause job losses in an economy. However, such notions are largely misguided. In fact, evidence from the United States shows that trade deficits are inversely correlated with unemployment, that is, when the trade deficit is rising, unemployment is low and when the trade deficit is being reduced, unemployment is high. When unemployment is low, people have more money to consume resulting in an increase in trade deficits and when unemployment is high, people have lesser money, resulting in less purchases from abroad and hence a smaller trade deficit.



²⁰ International Monetary Fund (IMF), 2014, “Germany – 2014 Article IV Consultation”, Staff report, July 2014.

²¹ Harvard Caps Harris Poll, 2018, .

Source: https://saylordotorg.github.io/text_international-finance-theory-and-policy/s06-02-trade-imbances-and-jobs.html

Policies that aim at reducing trade deficits may not always be positive. Trade deficits can help to create jobs and increase economic growth. Taking the example of America's trade deficit with China, this means that Americans buy more goods and services from China than the Chinese do from the United States. As a result, cash flows out of the States to China, which in turn is channeled for productive investment opportunities domestically, and sometimes back in the United States. In 2017, Americans bought about US\$552 billion more goods and services from abroad than foreigners purchased from the States. But this amount was re-invested back in the States, creating jobs and increasing economic growth²².

Trade deficits also allow consumers to access products for a cheaper price than those produced locally. This thus allows these economies to refocus their resources to producing higher-value products and buy cheaper products from exporting countries. For instance, Japan's trade deficits with other Asian economies has allowed it to focus its efforts in producing high-quality and capital-intensive products which have created many high-income jobs for its workers²³.

Balance of trade is indeed not an accurate portrayal of the gains of trade. The balance of payment matters. There is also the increasing difficulty of capturing the new forms of trade, such as digital trade.

In general, trade imbalances are driven by natural market forces and reflect diverse borrowing and lending practices across the globe, often resulting in higher overall global economic growth. Problematic trade deficits occur when governments borrow in countries with weak economic or political institutions or when smaller economies have unstable or weak free capital flows. Likewise, while trade surpluses may be positive, if they are persistent, they may be indicative of weak domestic demand. A country may have a trade surplus with certain countries, but a trade deficit with others. In well-functioning economies, trade deficits/surpluses are not an inherent problem and should not be used as a measure of a country's trade performance.

²² Federal Reserve Bank of St. Louis, 2017, "Trade Balance: Goods and Services, Balance of Payments Basis", <https://fred.stlouisfed.org/series/BOPGSTB>.

²³ Japan times, 2019, "Japan logs trade deficit for third straight month on weak exports to Asia", <https://www.japantimes.co.jp/news/2019/10/21/business/economy-business/japan-trade-deficit-third-straight-month-on-weak-exports-to-asia/>.

2. The disadvantages of trade tend to be exaggerated and misleading

Trade is itself a powerful driver of structural change, helping to reallocate resources to the sectors and areas where they can be most efficient. By reallocating resources from more efficient to less efficient sectors, workers working in more efficient sectors benefit from this reallocation, while those in less efficient sectors may lose out. Some import-competing industries in advanced countries have seen significant job losses particularly in the manufacturing sector, inciting the misconception that trade is the root cause behind the decline of the manufacturing industry in advanced economies. In fact, the decline in manufacturing jobs in advanced economies has been dominated by changes in the composition of demand and ongoing increases in productivity. For instance, in the case of the United States, the 5.8 million manufacturing jobs losses recorded between 2000 and 2010 largely reflected ongoing productivity increases, according to a McKinsey study. In addition, the study reports that only 20 percent of the decline in manufacturing jobs in the States can be attributed to trade or offshoring²⁴. This trend is also a consequence of efficient domestic policies (welfare system, neutral industrial policies, education, training and so forth). As advanced economies experience increased productivity in capital-intensive sectors such as services rather than manufacturing, resources are efficiently allocated from manufacturing to more productive sectors resulting in job losses in manufacturing sectors. There are also observations that neglected regions and provinces which have undergone a long period of industrial and demographic decay do not appear to reap the fruits of the trade agreements.

With the demise of low productive sectors and the resulting loss of jobs in these sectors, trade liberalization may forcibly displace workers. While such displacement implies a better reallocation of resources towards more productive sectors, workers unable to adjust for work in the new sectors do experience long spells of unemployment and uncertainty. Political rhetoric focus on these displaced workers and thus advocate for greater trade protectionism in order to protect these workers. However, data shows that the extent of displacement may be smaller than what is perceived in the media. An OECD paper²⁵ estimates that only up to 6 percent of workers change sectors in response to trade liberalization, which is a similar percentage to the average working displacing. Implementing protectionist trade measures will not help to protect these jobs as it will inevitably impede the growth

²⁴ McKinsey Global Institute, 2012, "Trading myths: Addressing misconceptions about trade, jobs and competitiveness".

²⁵ OECD, 2016, "Market Opening, Growth and Employment", OECD Trade Policy Papers No. 214.

of more productive and high-income sectors and jobs. Rather, policies focusing on upskilling workers and other active labour market policies are more appropriate.²⁶

3. Trade liberalization has significant positive impacts on the economy which are often neglected

By focusing on public's perceptions on the adjustment costs resulting from trade liberalization efforts, political rhetoric highlights the negatives of trade and ignores that trade can be positive. In fact, trade liberalization has played an important role in promoting economic growth, skill upgrade, creating good and quality employment opportunities and leading to an overall betterment of individuals. For example, studies have concluded that Bangladesh's trade liberalisation since 1990 has resulted in an increase in exports and imports, accelerated growth of its GDP as well as reduced its poverty rate²⁷.

There is widespread evidence that attests to relatively open economies growing faster than relatively closed economies, and salaries and working conditions are generally better in companies that trade than those that do not²⁸. Global trade and GDP growth are positively correlated: times of low growth have been those when economic integration was slowing or had reversed²⁹. Rising trade ratios are also broadly correlated with overall increases in productivity over the long run³⁰.

By boosting growth, trade has contributed to lifting hundreds of millions of people out of poverty: the share of the world's population living on less than USD 1.90 per day fell from around 35 percent in 1990 to less than 11 percent in 2013³¹. Evidence on the impact of trade on poverty in developing countries over 1993-2008 shows that the change in the real income of the bottom 20 percent of the population is strongly correlated with the change in trade openness over the same period³². Inequality among countries has also fallen³³. Thus, it is wrong to characterize trade as being a "race to the bottom".

²⁶ OECD, 2019, "Employment Outlook 2019".

²⁷ Peterson Institute for International Economics, 1999, "Evaluating the Success of Trade Liberalisation in Bangladesh".

²⁸ OECD, 2012, "Policy priorities for international trade and jobs".

²⁹ OECD, 2016, "OECD economic outlook", Volume 2016 Issue 2.

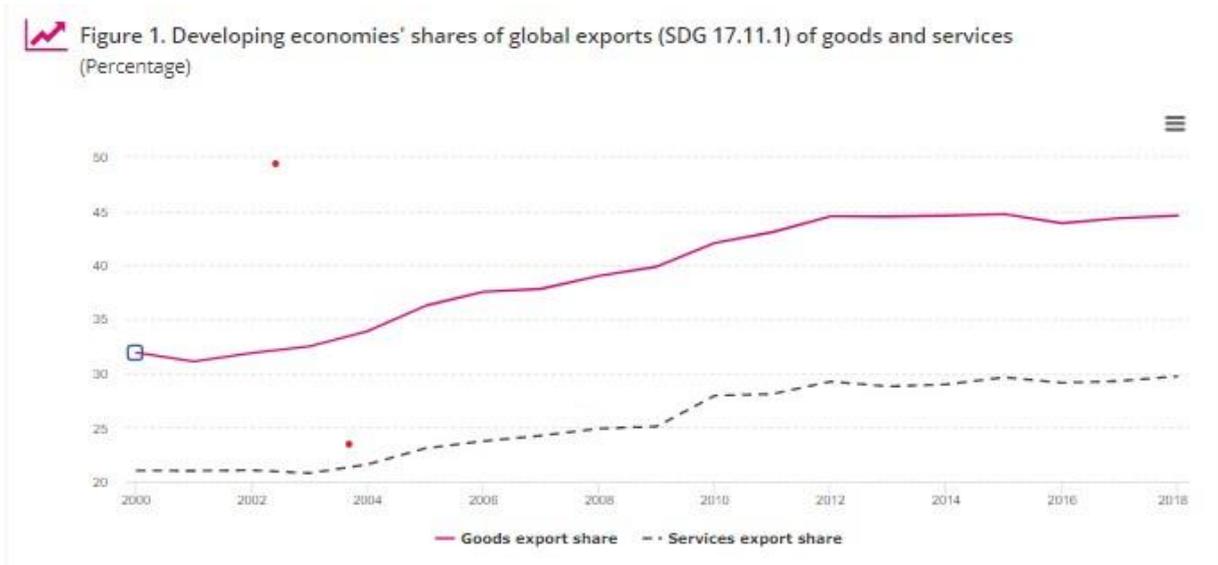
³⁰ Newfarmer, R. and Sztajerowska, M., 2012, "Trade and employment in a fast-changing world".

³¹ World Bank, 2016, "World Development Indicators".

³² IMF, 2017, "Understanding the downward trend in labour income shares", World Economic Outlook.

³³ Dabla-Norris, E., Kocher, K., Ricki, F., Suphaphiphat, N. and Tsounta, E., 2015, "Causes and consequences of income inequality: A global perspective", IMF Discussion Note.

Developing and emerging economies are also playing a more important role in trade today more than ever before by participating in global value chains and in services trade³⁴, as shown in the graph below.



Source: UNCTAD (2019)³⁵

This has not only improved lives and created new opportunities in poor countries, but also created new markets and opportunities for advanced economies. And more prosperity and opportunity around the world also helps promote greater stability and security for everyone.

Participation in global value chains is also associated with economic benefits such as productivity growth, less concentrated export baskets and growing sophistication of exports³⁶. Evidence also suggests better diffusion of frontier technology and innovation (in industrial and business processes) between firms that are engaged in global value chains and frontier firms³⁷. Small and Medium Enterprises (SMEs) in particular stand to gain from spillovers of technology and managerial know-how, as well as opportunities to scale up and enhance productivity. The more a country trades, the more technology and ideas spread; workers get more done, and higher productivity leads to better wages.

Trade has delivered unprecedented access to a wide range of goods and services, as well as huge reduction in consumer prices worldwide. For example, due to trade liberalization electronics now face some of the lowest trade barriers. Significant reductions in trade barriers as well as other factors

³⁴ OECD, 2017, OECD calculations based on the World Integrated Trade Solution (WITS) Database.

³⁵ UNCTADStat, 2019.

³⁶ Kowalski, P., Lopez-Gonzalez, J., Ragoussis, A. and Ugarte, C., 2015, "Participation of developing countries in global value chains: Implications for trade and trade-related policies", OECD Trade Policy Papers, No. 179.

³⁷ Saia, A., Andrews, D. and Albrizio, S., 2015, "Productivity spillovers from the global frontier and public policy: Industry-level evidence", OECD Economics Department Working Papers, No. 1238.

resulted in extraordinary falls in the price of electronic products: between 1980 and 2014 the price of a (roughly comparable) TV set has been cut by 73% and the price of a microwave by 93% – and the smart TV sets and microwaves we buy today are vastly better than those available in the 1980s (OECD WITS Database, 2017). Such lower prices due to trade liberalization are particularly beneficial for poor households.

Ignoring the positive relationship between trade liberalization and economic outcomes skews political discourse against trade liberalization efforts and results in a growing atmosphere of distrust and discontentment over the current trading system. Such rhetoric and misconception have been partly responsible for increasing trade protectionism, further stagnating global economic growth. In fact, rising protectionism has been proven to be counterproductive, often hurting low-income households and emerging economies disproportionately. In an OECD analysis of a hypothetical scenario in which Europe, the United States and China raised trade costs for all partners on all goods by 10 percentage points, the estimated impacts were lower world GDP by 1.4 percent and lower global trade by 6 percent, with the countries imposing the trade barriers lowering their own GDP by the most³⁸. The same is true for jobs. With domestic firms needing competitively priced imports, simple policies of just raising tariffs risks destroying jobs by putting SMEs out of business and encouraging big companies to send more jobs overseas.

It is therefore vital that the political discourse and public debate around trade be rooted in facts rather than misperception so as to maintain what has been achieved and continue to make considerable progress towards dismantling existing restrictions to trade. But it is not sufficient to focus on simply trade openness and trade liberalization policies to ensure that the gains of trade are equitably distributed. For trade openness to be positive on jobs, economic growth and development, the conditions of the domestic economy need to be favorable. This means that proper infrastructure needs to be in place, strong institutions need to be present and adequate labour markets, financial markets institutions and regulations. This should also be supported by strong education and training systems. In short, for economies to realize the gains to trade, governments need to ensure a favorable business and investment environment for trade openness, which will require appropriate domestic and international policies to be in place. Domestic policies should consider inclusive and sustainable growth, structural policies and compensatory policies while international policies should focus on trade liberalisation efforts and correctly interpreting and implementing labour provisions in trade agreements.

³⁸ OECD, 2016, “OECD Economic Outlook”, Vol. 2016 Issue 2.

Policy Recommendations

In order for the gains of trade to be maximized and equitably distributed, governments need to act across many fronts simultaneously, acknowledging that the impact of global trade on people depends both on national policy settings of the countries in which they live and on the nature and degree of international economic cooperation. This implies working across silos and taking a much more integrated policy approach, both domestically and internationally. This section considers some domestic and international policies that can help to ensure that the full benefits of trade liberalization are realized.

Domestic policies

Inclusive growth policies

The impact of trade liberalization on growth and in turn on employment depends very much on the conditions in the domestic economy that enable benefits to materialize and be fairly distributed and for firms to have the capacity to take advantage of new opportunities³⁹. In order for trade liberalization to realize its full benefits, policies promoting macroeconomic stability and inclusive growth are necessary. This includes labour force adjustment policies, education and skills development.

Many current labour force adjustment policies, where they exist, do not always seem to be working as intended. Programmes sometimes suffer from limited resources, poor targeting, conflicting measures and poor coordination. Workers displaced from manufacturing in some advanced economies sometimes struggle to move into new jobs, notably in services. This is particularly true where other factors combine with trade shocks such as in the environment of slow growth or structural barriers such as corruption, weak institutions, poor physical trade and investment infrastructure, among others. Inclusive growth policies should thus focus on filling the gaps in current labour force adjustment policies.

Furthermore, labour force adjustment policies that focus only on the displaced are not enough. Investments that support both people and growth by ensuring access to good quality health and education for everyone strengthens opportunities for all, including the most disadvantaged. Effective activation frameworks that bring more people into the labour force and make work pay are necessary. A workforce with adequate and adaptable skills is key to ensuring equitable distribution of the benefits

³⁹ OECD, 2019, "Going for Growth 2019".

of trade. An appropriate and up-to-date skills policy is needed to ensure that people are adequately equipped with the technical skills to work in new and in-demand sectors.

Other than technical skills, investments in education and training should also focus on equipping workers with cognitive, social and emotional skills, which are increasingly demanded for in the digital economy. Such skills have been shown to help workers transition across occupations, industries and regions. Moreover, highly educated workers and workers receiving in-house vocational training face less risk of layoff than their less educated and non-trained counterparts, largely due to their increased capacity to adapt to new tasks. In the event of a layoff, such workers have been shown to find jobs more quickly⁴⁰. As such, individuals will need to change their mindsets and be open to reskilling and upgrading themselves in today's changing world of work.

To ensure that labour is well-equipped will require education policies to not only adapt to changing skills requirements resulting from technological change, but also be forward-looking in anticipating the evolving needs of future firms and developing appropriate programs to cultivate those skills. It is important that such policies are developed in close collaboration with employers, and employers are further supported by public policies to invest more in vocational and company training for displaced workers. Currently, existing investment chapters and labour provisions in trade agreements do not cover the scope of education or skill policies. Due consideration may need to be given to these aspects when negotiating trade agreements in the future.

Structural policies

Addressing trade adjustment costs may require structural reform, particularly in economies with rigid and poor institutions. Structural barriers include weak institutions, widespread informality and poor physical and business services infrastructure which in turn impact the way domestic and trade policies are implemented. A recent International Monetary Fund (IMF) paper shows that structural reforms have, in general, a positive impact on output and employment, ensuring that trade policies are soundly implemented and the gains of trade equitably distributed⁴¹.

Introducing infrastructure projects or improving the quality of existing infrastructure can be extremely useful in reducing trade barriers and input costs. The OECD reports past infrastructure activity being responsible for raising GDP per capita in the long term, generally though the effect varies across different types of spending and across countries⁴². Investment in physical infrastructure including

⁴⁰ OECD, 2019, "OECD Skills Outlook 2019: Thriving in a Digital World".

⁴¹ Antoun de Almeida, L. and Balasundharam, V., 2018, "On the Impact of Structural Reforms on Output and Employment: Evidence from a Cross-Country Firm-level Analysis", IMF Working Paper WP/18/73.

⁴² OECD, 2019, "Economic Policy Reforms: Going for Growth", Chapter 1 on Structural Reform at a Time of Financial Crisis.

investment in digital infrastructures not only affects economic performance but connects people to health and education opportunities and firms to high productivity areas. In particular, the OECD shows that digitalization has benefitted firms with better access to key technical, managerial and organizational skills, further improving their productivity⁴³.

Investing in supply capacities of an economy needs to be underpinned by sound regulatory frameworks that connect people to jobs and markets and enable them to participate in new opportunities. Furthermore, having a clear set of laws navigating the workplace can further help in combating corruption and preventing informality. Productivity-enhancing investments help to increase long-term supply investments as well as boost demand in the short term⁴⁴.

In particular, a key challenge in the integration of developing countries into the global trading system is the range and technological content of goods and services they produce for export. Promoting value addition and enhancing domestic productive capacity is therefore of crucial importance in developing countries so that they can seek to participate beneficially in global trade⁴⁵.

Compensatory policies

Trade liberalization, while providing benefits to some sectors through the reallocation of resources to more productive sectors, may also imply the need to adopt compensatory policies toward those sectors such as agriculture or manufacturing that lose from more economic openness. It is therefore important to build progressively modern and sustainable social protection schemes, once there is fiscal space, to ensure not just sustainable and adequate safety nets for displaced workers but also to provide more opportunities for people to re-skill throughout their working lives as well as providing access to credit and social services to facilitate mobility.

This means that a wide-range of social protection schemes need to be developed, rather than having a “one-size-fits-all” approach. While this may be desirable, it may not always be feasible in the short run especially for developing economies. In these instances, targeted social programmes sometimes of limited duration could be a useful alternative. Continuously monitoring the efficiency and impact of these programmes is critical in better understanding appropriate and affordable social programmes, as well as avoiding poverty traps.

The presence of a large informal sector prevents the gains of trade from being equitably distributed. For example, informal employment makes up 58.7 percent of non-agricultural employment in Middle

⁴³ OECD, 2019, “Digitalisation and productivity”, <https://www.oecd.org/economy/growth/digitalisation-productivity-and-inclusiveness/>.

⁴⁴ OECD, 2016, “OECD Economic Outlook”, Vol. 2016, Issue 2.

⁴⁵ UNCTAD, 2019, “Promoting value addition and the enhancement of domestic productive capacity through local economic empowerment”.

East – North Africa, 64.6 percent in Latin America, 79.4 percent in Asia, and 80.4 percent in sub-Saharan Africa⁴⁶. On the worker side, informality can prevent workers from receiving employment-related benefits such as health and social security, which may be improved due to trade gains. In addition to not receiving these benefits informal workers are not protected by labour laws, have difficulty saving due to low wages resulting in lower consumption, and may also be invisible to tax authorities resulting in tax evasion. On the firm side, informality implies that informal firms are exempt from relevant regulations, resulting in substantial tax evasion that can hinder an economy's fiscal capacity and its provision of public goods. In addition, it might also entail substantial misallocation of resources and hamper growth as non-productive firms can survive by evading taxes and avoiding compliance with labour market regulations. Thus, eradicating the informal sector and fighting corruption are critical and should be strong priorities. Informality hinders workers to benefit from trade liberalization. It can allow for the gains of trade to be expanded to workers and firms previously untouched by these policies. International cooperation is also essential for efforts to crack down on tax avoidance and evasion at the international level, thereby helping to limit informality in countries. Such efforts have shown to pay off in the EU where more than 80 billion Euros have been yielded thanks to the introduction of voluntary disclosure programs and strengthened transparency standards⁴⁷.

Many tax and benefit systems across the OECD area have been shown to have become less distributive, leading to inequitable distribution of the gains of trade⁴⁸. According to the OECD, expansions in the amount of tax revenue have been financed predominantly through taxes on labour and higher rates of value-added tax, affecting more the middle class and low-income households respectively. It is thus important to ensure that tax and benefit systems are designed with promoting both growth and equity in mind, so as to ensure equitable redistribution of the gains of trade.

International policies

Trade liberalization

Reducing trade barriers in the form of tariffs have shown to be successful for decades. Over the course of 70 years, the average applied global weighted tariff fell from as high as 22-40 percent in 1947 to between 2-5 percent in recent years, reducing the cost of goods and services across the globe⁴⁹. While in some sectors, especially agriculture, tariffs still constitute a major barrier to trade, in other sectors

⁴⁶ Charmes, J., 2016, "The informal economy: Definitions, Size, Contribution, Characteristics and Trends", RNSF, Rome.

⁴⁷ OECD, 2017, "Making Trade Work for All".

⁴⁸ OECD, 2015, "In it together: Why less inequality benefits all".

⁴⁹ Chad Brown and Douglas Irwin, 2015, "The Urban Legend: Pre-GATT Tariffs of 40%", VOX, <http://voxeu.org/article/myth-40-pre-gatt-tariffs>.

the largest potential benefits lie in eliminating existing non-tariff barriers (NTBs). These include protectionist policies such as localization requirements, discriminatory procurement procedures, and barriers to trade in services.

The removal of NTBs can help young firms especially SMEs to participate in international markets thereby creating jobs. Reform of slow or cumbersome border procedures have been shown to cut the costs of trading by 12 to 18 percent depending on a country's level of development, allowing more firms to export into, or source high quality inputs from global markets⁵⁰.

Ensuring access to efficient and affordable business services is essential for both firm competitiveness and individual well-being. Restrictions on services trade impose costs on local firms that rely on efficient services to be competitive in export markets: this impact is estimated to be equivalent to a sales tax of between 3 percent and 38 percent on purchased services depending on the sector, particularly disadvantaging SMEs⁵¹. Improving digital trade can reduce transaction costs immensely, thus enabling significant efficiency gains as well as facilitating the integration of developing countries and micro, small, and medium enterprises (MSMEs) into global value chains.

However, a precondition for these benefits is a significant improvement in e-commerce readiness, which in turn is driven by effective information and communication technology (ICT) infrastructure, an appropriate legal framework, and a citizenry with suitable digital skills. The potential of digital trade is considerably hampered by the increasing number of barriers being enacted, such as discriminatory and incompatible standards and regulations affecting e-commerce, localization requirements, and limitations on the free flow of data. Removing these barriers help to increase growth potential and benefits consumers.

The exponential growth of FDI flows and stocks over the past decades has driven globalization, boosted trade and fostered the intertwining of economies through global value chains⁵². FDI is important for all countries, but can be particularly beneficial for developing countries. It creates jobs in local markets, supports infrastructure development and allows for the production and sale of new goods in circumstances where trade may not be feasible due to prohibitive costs, policies or other factors.

To date, investment facilitation has received relatively little attention compared to trade facilitation. According to the OECD FDI Restrictiveness Index, multiple restrictions to international investment

⁵⁰ OECD, 2015, "Implementation of the WTO Trade Facilitation Agreement: The potential impact on trade costs", Policy Brief.

⁵¹ OECD, 2016, "OECD Economic Outlook", Vol. 2016, Issue 2.

⁵² UNCTAD, 2014, "World Investment Report".

remain in many sectors of G20 members' economies, hampering growth-conducive FDI⁵³. While many countries have national efforts aimed at investment promotion – like image building, the provision of market information or incentives – between 2010 and 2015 less than a quarter of the measures involved touched on investment facilitation⁵⁴. In addition, international investment agreements (IIAs) have relatively few components aimed at investment facilitation. As a result, enhancing national and international initiatives to facilitate investment remains an area with a lot of room for action, and a high potential for positive returns for both businesses and countries.

Facilitating investments by removing barriers to FDI, whether they are policies, administrative obstacles, logistical barriers or efforts that include support to improve investment capacity. Many developing countries would benefit from a defined investment facilitation plan to deliver their value proposition, but do not have the internal capacity to develop one. They can be supported by international organisations and developed economies who can share their best practice recommendations as well as support capacity-building efforts by the developing economies.

Currently, the global investment system remains a complex system of bilateral and regional treaties. While these generally foster investment flows, the disparity of agreements creates ambiguity and unnecessary costs for both firms and governments. By decreasing complexity, rising legal liability, and facilitating FDI a multilateral investment framework could thus lead to more efficient investment allocation, resulting in substantial beneficial effects on growth and development.

International trade agreements and labour provisions

Trade agreements, be it multilateral or regional or bilateral, are instrumental in setting the rules for trading partners. Such agreements explicitly state these rules in order to ensure a level playing field for all trading partners involved. While bilateral and regional trade agreements can complement the multilateral trading system, the gains of trade often are limited to the countries covered by the agreement and may not necessarily extend to other non-participants. Having multiple bilateral trade agreements may also create complex differing terms across different trading partners. As such, it is important to ensure that more countries are involved in these agreements so as to maximize the benefits of trade liberalization. Such international cooperation is necessary in leveling the playing field. For instance, an OECD simulation showed a doubling of GDP when an RTA involving only high-income Asian economies was expanded to include all Asian economies.

⁵³ OECD, 2017, “FDI Regulatory Restrictiveness Index”.

⁵⁴ UNCTAD and OECD, 16th Report on G20 Investment Measures (November 2016), accessed February 8, 2017, http://unctad.org/en/PublicationsLibrary/unctad_oecd2016d16_en.pdf.

While the earlier section has shown the growth of labour provisions in trade agreements, controversy remains concerning the impact of such provisions on trade outcomes. Some academic research failed to find positive or even significant impact of labour provisions on trade outcomes, questioning the relevance of such provisions in trade agreements. For instance, Kamata⁵⁵ shows that there was no significant impact of the inclusion of labour provisions on actual working conditions such as wages, hours worked, fatal occupational injury rate and the number of ILO core conventions ratified. Other similar studies such as Aggarwal⁵⁶, Rodrik⁵⁷ and Brown⁵⁸ have mostly found insignificant or non-conclusive results of the impact of labour provisions on employment and other working conditions.

Be this as it may, the decision to include labour provisions in trade agreements should in any case only be taken after consulting with appropriate institutions, including national workers' and employers' and business organizations (EBMOs) as they are best placed to assess the potential effect of such provisions. This is far from what is in practice: it is very common for governments to agree on provisions without proper consultations with the affected social partners. Moreover, it seems important to ensure that such provisions are appropriately interpreted and applied. Seventy-two percent of trade-related labour provisions make reference to ILO instruments. Most include legally binding commitments with respect to fundamental principles and rights at work, working terms and conditions, and mechanisms for dispute resolution in case of violation of these obligations. It is important to note here that these ILO instruments are a result of intense tripartite discussion, and application of such ILO standards in labour provisions thereby require a good understanding of that discussion. An incorrect or controversial interpretation of a particular standard may lead to a less than successful application of the standard within the economy and in turn lead to counterproductive results.

In addition, the legal commitment of the trade parties vis-à-vis the referenced ILO Conventions differs depending on whether or not the State has ratified the applicable Conventions. Where the country has already ratified the referenced Convention, the country does not necessarily face additional legal obligations regarding that standard. However, where the country has not ratified the Convention, the State may have to modify domestic labour law and practice. In some instances, the country may face barriers in changing its law and practice and thus applying the respective ILO Convention. Agreeing to

⁵⁵ Kamata, I. 2015, "Labour Clauses in Regional Trade Agreements and Effects on Labour Conditions: An Empirical Analysis", IDE Discussion Paper No.609.

⁵⁶ Aggarwal, M., 1995, "International Trade, Labour Standards and Labour Market Conditions: An Evaluation of the Linkages", USITC, Office of Economics Working Paper No.95-06-C.

⁵⁷ Rodrik, D., 1996, "Labour Standards in International Trade: Do They Matter and What Do We Do About them?".

⁵⁸ Brown, D.K., 2000, "International Trade and Core Labour Standards: A Survey of the Recent Literature", Labour Market and Social Policy, Occasional Papers No.43.

ratify a Convention through discussions on trade agreements while ignoring the practical problems involved in ratification and implementation can create confusion to the application of domestic law, leading to counterproductive outcomes. Engagement of tripartite constituents is important.

Labour provisions in trade agreements might create a level playing field amongst the countries included in the trade agreements. Including labour provisions may also help consolidate and further improve the implementation of FPRW. However, when there are disagreements regarding the inclusion of labour provisions, especially when countries for particular reasons have not ratified the relevant ILO standards, such inclusion needs to be carefully addressed with the full involvement of tripartite constituents.

All the above policy recommendations are even more essential today in light of the recent COVID-19 pandemic. Due to the spread of COVID-19 virus, governments have been forced to take strict measures such as closing down borders in order to protect people's lives. These measures inevitably will have painful consequences for households and businesses. To mitigate the economic damage of the crisis, policymakers will need to lay the right foundations for a strong, sustained and socially inclusive recovery. Trade will be an important part of that solution. Keeping markets open and predictable as well as fostering a more generally favorable business environment will be critical to spurring the renewed investment needed to rebound the global economy. In addition, multilateral cooperation across countries is crucial in ensuring a speedier recovery than if each country acts alone.

Call for action to national EBMOs

An integrated policy approach requires trade policy making to become an open conversation and be action-oriented. This in turn means that social partners should be involved in national policymaking as they are the ones directly impacted by both domestic and international policies governing the terms of trade. This is well exhibited in some OECD countries. To this extent, national EBMOs can be instrumental in ensuring that the interests of businesses are duly taken into consideration in national policy making debates as well as in the negotiation of labour clauses in trade agreements.

EBMOs, in particular, are well-placed to participate in national policymaking as they are capable of bringing in up-to-date information and data that can support empirical policymaking. In addition, EBMOs are also able to bring in actual experience and expertise from businesses not only operating locally but also overseas, thereby highlighting the barriers of trade and investment in doing business.

In addition to supporting national policymaking, EBMOs can support their members by providing them with up-to-date information on global trade so that businesses are well informed about doing business

locally and overseas. The IOE with its extensive network of EOs globally is a useful resource in this area as it can support its members with up-to-date information on global trade trends and the ease of doing business in the different economies. Furthermore, the IOE can support advocacy efforts by members to push for properly framed and progressive trade liberalization efforts in their economies.

With regards to labour clauses, involving the tripartite parties in trade discussions can shed further light on whether to include a particular labour standard in the first place and subsequently how to correctly interpret the labour clauses if included in trade agreements. Understanding how to correctly interpret and apply the clauses is a useful expertise that EBMOs can offer to such discussions, so as to eliminate confusion regarding the interpretation of such provisions. In some countries, the engagement of EBMOs in trade negotiations allow for access to a myriad of skilled expertise including industry associations. IOE can support its members with a correct interpretation of these labour provisions. Trade openness and free trade are vital for jobs and growth.

Only a more modern, flexible, comprehensive and coherent package of domestic and international policies can help ensure that global trade becomes more free, fair and open. To this extent, businesses have an essential role in this endeavor, but it cannot and should not be expected to bear this burden alone.



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