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**INTERNATIONAL TRADE AND LABOUR MARKET  
PERFORMANCE:  
MAJOR FINDINGS AND OPEN QUESTIONS**

by

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## **ABSTRACT**

This paper surveys the findings arising from existing research and suggests some directions for improving our understanding of the links between international trade and the labour market. Three routes for further research seem particularly promising. First, an effort should be made to put in relation labour market variables directly with trade policy measures. Second, there is a need to address the issue of trade and labour market outcomes from a consistent cross-country perspective. Finally, the role of labour market institutions and production internationalization (through outsourcing, international exchange of intermediate inputs or FDI) should be further explored.

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## I. INTRODUCTION

The wage and employment conditions of unskilled workers in many developed countries have deteriorated during the last couple of decades. Depending on which countries are considered, this tendency may show up either as a reduction in employment perspectives for unskilled workers (continental Europe) or as a reduction in their relative, and even absolute, earnings (United States). During the same period, the labour markets in developing countries have been showing opposite tendencies, depending on the geographical aggregates considered. While disguised unemployment and wage inequality have been falling in many Asian countries, labour market conditions have been sluggish in Latin America, and inequalities have been increasing.

At the beginning of the 1990s, the focus of the analysis of labour market developments has shifted from a short-run, to a long-run, structural perspective. The persistence of growing unemployment or falling wages in a number of developed countries gave rise to the view that the deterioration of the economic position of unskilled workers is to be attributed to a long-run tendency that is driving the fundamentals of the economy.<sup>1</sup> Two major structural changes have characterized the last 20 years: the introduction of information technologies and the growth in world trade and capital movements. Growing trade is, to a non-negligible extent, attributable to liberal trade reforms adopted in many developing countries. The current worldwide developments parallel those at the beginning of the 20<sup>th</sup> century, when rapid technical change and increased international mobility for goods and production factors were coupled with increasing

inequality in the developed world. During that period, however, labour migration seems to have played a major role, whereas in the current situation, the international movement of workers is not of a comparable magnitude (Baldwin and Martin, 1999). Research suggests that the explanation for the deteriorating situation of unskilled workers is to be found in a tendency towards declining demand for the services of unskilled labour (Katz and Murphy, 1992; OECD, 1997; World Bank, 1995; Slaughter and Swagel, 1997).

Technological change and the process of “globalization” – namely, institutional and technical developments that are reducing the mobility barriers for goods and production factors – may both be responsible for causing a secular downturn in the demand for unskilled labour. As for technological change, it may cause a reduction in the demand for unskilled labour if newly introduced technologies are sufficiently “skill-biased”. Trade-related developments are generally thought to affect the demand for different types of labour through the intersectoral composition of the demand for goods.

Globalization and technological change differ in a fundamental sense. While technological progress is driven by innovations whose development and adoption can be influenced by the policy environment only to some extent, the openness of markets absolutely depends on laws and regulations imposed by sovereign Governments. Understanding the origins of the developments observed in the labour market has primary implications for economic policy. Not sur-

prisingly, there has been a lively debate in recent years, focused on the identification of the forces shaping the demand for labour in the North. Empirical work has proliferated, and alternative techniques have been confronted with the aim of assessing the relative importance of technology and trade as alternative explanations for the observed reduction in the demand for unskilled labour.

The aim of this paper is to summarize the results of recent research into the effects of trade on labour demand, and to identify some open questions and directions for further research. Three paths are identified as particularly promising. First, an effort should be made to relate labour market variables directly to trade policy measures. Second, the links between trade and the la-

bour market should be addressed from a consistent cross-country perspective. Third, the role of labour market institutions and production internationalization (outsourcing, international exchange of intermediate inputs, foreign direct investment) should be further explored.

The next section summarizes some basic facts about world trends in trade integration, employment and wage inequality. Section III illustrates the explanations commonly offered by labour and trade economists to account for the effects of trade on employment and wage dynamics, and assess the findings of empirical research on that issue. Section IV identifies some open questions and paths for further research. Section V concludes.

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