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TUAC Comments on "A Policy Framework for Investment: Human Resource Development Policy" (DAF/INV/TF(2005)11/REV1)

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One of the underlying assumptions of this paper is the perception that labour market institutions, in particular trade unions, are an impediment to investment, growth, productivity and job creation. Following closely the standard textbook version of labour market theory, the text equates full wage and employment flexibility with a set of optimal labour market results for workers, employers and investors. In reality, however, we find rarely examples of fully flexible wages or employment. Moreover, and even more important, it must be noted that there is little support for a complete wage and employment flexibility. That applies not only to workers and their organisations, trade union organisations. It also applies to employers. Hence, properly functioning industrial relations, including collective bargaining based on equal footing, are an essential prerequisite of democracy and sustainable development.

Collective bargaining serves a dual purpose. It provides a means of determining the wages and conditions of work applying to the group of workers covered by the ensuing agreement through free and voluntary negotiations between the two independent parties concerned. It also enables employers and workers to define by agreement the rules governing their relationship. These two aspects of the bargaining process are closely interrelated.

Collective bargaining in general is advantageous for both workers and employers. For workers, collective bargaining, more so than individual employment relations, ensures adequate wages and working conditions by providing them with a "collective voice". It also allows them to influence personnel decisions and to achieve a fair distribution of gains from technological progress and productivity increases. For employers, collective bargaining helps maintain industrial peace that otherwise may be disrupted by labour unrest. The risk of disruptions by labour unrest is particularly high with regard to decentralised shop floor or single employer bargaining. Through collective bargaining employers can also address the need for adjustment to facilitate modernisation and restructuring. Contrary to the conventional belief, it can be argued that collective bargaining has been one of the main consensual means of introducing labour market flexibility in many countries.

It is anything but surprising that a recent study by the World Bank, focusing on *Unions and Collective Bargaining: Economic Effects in a Global Environment*, says that high unionisation rates can improve economic performance (in the form of lower unemployment and inflation, higher productivity and speedier adjustment to shocks).[1] The study, which reviewed more than a thousand studies on the effects of unions and collective bargaining, finds that bargaining coordination between workers' and employers' organisations in wage setting and other aspects of employment (for example, working conditions) is an influential

[1] Aidt,T. / Tzannatos, Z.: Unions and Collective Bargaining: Economic Effects in a Global Environment. Economic Effects in a global Environment; Washington 2002.

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determinant of labour market outcomes and macroeconomic performance. Countries with highly-coordinated collective bargaining tend to be associated with lower and less persistent unemployment, lower earnings inequality, and fewer and shorter strikes than uncoordinated ones. In particular, coordination among employers tends to produce low unemployment. In contrast, fragmented unionism and many different union confederations are often associated with higher inflation and unemployment.

They study provided also evidence that collective bargaining is no impediment market related adjustment, innovation and restructuring of firms. Collective bargaining may limit numerical flexibility, i.e. the ability of employers to hire and fire workers quickly at a relative low cost. However, it is conducive to functional flexibility by facilitating the redeployment of workers inside the firm. It is anything than surprising, that contrary to economic wisdom trade union affiliation of workers can increase the concerned firm's incentives to innovate and thus to improve competitiveness.

Thus it is appropriate to emphasise in a Policy Framework for Investment the important and positive role performed by trade unions. Hence, the Policy Framework should abstain from recommending unilateral industrial relation policies aiming to promote decentralised or individual bargaining. In respect of the rights of freedom of association and collective barraging, two essential core labour standards, the design and implementation of appropriate bargaining systems and procedures should be left to trade unions and employer's associations.

Moreover, the envisaged Policy Framework should also abstain from suggesting a one-size-fits-all approach with regard to the design of labour market flexibility and employment protection legislation (EPL). The *Task Force on a Policy Framework for Investment* should resist old habits and not try to shoehorn every national economy into an identical set of policies. What is necessary is a nuanced understanding of both national and local labour markets and a truly democratic approach to economic policy, accepting that different countries require different kinds of economic policies. In this respect, the *Task Force* must take into account some key lessons from the 2004 issue of the OECD's annual Employment Outlook, which includes a review of the theoretical aspects and empirical effects of employment protection legislation (EPL). The lessons to be learned are as follows:

1st, countries generally adopt deliberately institutions that reduce labour-market flexibility for good reasons, namely to shield workers from economic uncertainty and hardship. The *Employment Outlook* notes, "any overall assessment of EPL has to weigh costs against benefits." The pronouncements of the draft on labour-market institutions, however, have been long on efficiency costs and short on social benefits. Thus, any advice for developing countries should spend as much time measuring the social benefits of EPL as measuring any efficiency costs.

2nd, in addition to social benefits, the labour-market institutions out of favor at the Task Force may actually increase the efficiency of national labour markets. The *Employment Outlook* notes rightly, that "the social value of a job may be higher than its private value. ... A job may thus become unproductive for an employer, while still generating some resources for society. Therefore, without government intervention, there would be too many layoffs compared to what would be socially and economically desirable."

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3rd, much of the case against labour-market institutions rests on empirical evidence that is not sufficiently conclusive to inform policy. In the case of EPL, for example, the *Employment*

Outlook cautions that "more tests for the robustness of the results should be carried out before drawing policy conclusions."

The commonly held view, that labour market rigidities are generally bad for investors and for the overall economic performance, a view consistent with the lines of the 1994 OECD Jobs Strategy recommendations, is not supported by compelling evidence. On the contrary, the OECD Growth Study and the ongoing reassessment of the OECD Jobs Strategy have revealed that there is evidence suggesting that different policy packages have equally successful outcomes regarding employment, growth and productivity. In a nutshell: countries, not following closely the policy recommendations of the rigidity account of unemployment have been rewarded with increases in employment and decreases in structural unemployment. A case in point is being provided by Denmark. The *Employment Outlook* concluded, for example, that Denmark's "flexicurity" system, which includes generous unemployment benefits, moderate employment protection, and "active labor market policies" to help the unemployed get back to work, produced outcomes at least as good as those obtained in the less protective United States.

Furthermore, this view has diverted attention from the importance of labour market regulation and inadvertently leading to growth of informal economic activities. This has greatly exacerbated the governance deficit in many countries.

An additional comment is necessary with regard to the assertion that “in many developing countries labour regulations are reported to be a significant obstacle to business operations” (Paragraph 12, Note by the Secretariat; DAF/INV/TF(2005)11/REV1) and the related figure. Both, the assertion and the figure are based on surveys on how employers perceive alleged labour regulations as constraints to the operations of their businesses. Leaving aside methodological problems related to such kinds of surveys and their interpretation (for example misperceptions, stereotypes, “assuming the answer” by the surveyor or a confusion of correlation and causation, to name but a few), the reported findings and conclusions are highly questionable. They are rather close to stereotypes and misperceptions, bearing little, if any, resemblance to reality. Recent figures on FDI inflows into those developing countries, characterised as discouraging investors due to strict labour regulations by Pierre and Scarpetta, the authors of the World Bank working paper on “*Employment Regulations through the eyes of Employers*”, are in a striking contrast to the conclusions drawn by the *Task Force*. According to Pierre and Scarpetta, one would neither expect China nor Brazil as major recipients of FDI in Asia respectively in Latin America. Instead, if the assumptions were close to reality and would capture the major determinants of investment decisions, one would expect rather developing countries like Uganda, Albania, Honduras, Haiti, Nicaragua or Malaysia to be among the largest recipients of FDI. All of them belong to the group of countries characterised by the least restrictive EPL provisions compared to countries like France or Portugal. By the same token one would neither expect China nor Brazil and Mexico to be among the largest recipients of FDI. What is particularly amasing in this respect is the fact that Mexico and Brazil are – according to Pierre and Scarpetta – the two countries with the most restrictive EPL.

The asserted link between EPL strictness and FDI is at best highly controversial, at worst snake oil. Hence, policy recommendations based on the alleged negative impact of EPL on FDI are inappropriate and misleading.

Table

EPL strictness and FDI inflow

Country	EPL-Strictness indicator	FDI inflow 2004 (Mill. of US-$
China	0,29	60 630
Brazil	0,68	18 166
Mexico	0,74	16 602
Uganda	0,08	237
Albania	0,17	426
Malaysia	0,15	4 624
Canada	0,09	6 293

Sources:
EPL-Strictness indicators according to Pierre, G. / Scarpetta, S: Employment Regulations through the eyes of Employers. Do they matter and how do firms respond to them?; World Bank working paper WPS 3463; the indicator runs from 0 to 1 in order to cover the range from the least to the most restrictive EPL regulation
FDI figures according to the World Investment Report 2005 by Unctad