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RIGHTS MAKE MIGHT

Ensuring workers' rights as a strategy for economic growth

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A multitude of pressing issues await the representatives of the World Bank and the International Monetary Fund (IMF) when they gather for their spring meetings in Washington, D.C. in April. High on the agenda will be the global economic slump and the continued financial instabilities in Latin America as well as issues related to the war in Iraq.

Unfortunately, the World Bank and the IMF are likely to ignore an important policy tool for ameliorating these problems: worker rights. Improved worker rights have been shown to offer a solid foundation for strong and stable economic growth by supporting demand and stabilizing local currencies and banking systems. Up to this point, however, the IMF and the World Bank have given short shrift to worker rights.[1]

The most basic of these worker rights have been codified by the International Labor Organization (ILO), which outlines five "core labor standards" (CLS) that all labor markets should strive to meet: the freedom of association; the right to collective bargaining; the abolition of forced or compulsory labor; the abolition of child labor; and freedom from discrimination. The arguments behind calls to enforce the CLS are not only morally unassailable but make good economic sense as well. In fact, a growing body of evidence highlights the economic benefits of these core labor standards:

- Better worker rights result in higher productivity growth, thus leading to faster economic growth.
- Improved worker rights also tend to result in a better distribution of income, both among workers and between workers and firms. In other words, better worker rights lead to larger overall output that gets more evenly distributed.

- As the benefits of faster growth are more evenly distributed, local demand is stronger and more stable, thus reducing the chance of a financial crisis.

If the World Bank and the IMF truly want to address the problems of sluggish economic growth and market instability, it is vital that the these powerful institutions finally add the adoption of labor standards and the implementation of worker rights to their policy prescriptions for emerging economies.

Sluggish growth and increased financial instability

Global economic growth is anemic. The United States and the European Union are both expected to grow less than 3.0% in 2003, and Japan's projected growth is only 1.1% (IMF 2002). Considering that productivity growth remains strong in all industrialized economies, these growth rates are too low to measurably lower unemployment.

The reason for this lackluster economic growth is too much global capacity. Faced with too few customers, firms increase profits by holding down wages and benefits, outsourcing work, and relocating to countries with weak worker protections and low labor costs. Often firms may even forego profits in the short-run, just to keep their existing capacities in use (e.g., by giving generous discounts or offering low cost financing). Ultimately prices begin falling (as has been the case in Japan for most of the last decade) and consumers and businesses become reluctant to shop or to invest as debt burdens grow and profit opportunities vanish.

The lack of customers is at least in part a result of national policies that often weaken worker rights. In Europe, the European Central Bank has kept interest rates high to the detriment of growth, while simultaneously pushing publicly for the reduction in labor protections. In Japan, savings rates remained high as households faced increasing uncertainty with the end of lifetime employment contracts. In the face of fewer safeguards for workers, rising unemployment dampened consumption, as did deflation. And in the United States, workers—facing a recession exacerbated by growing trade deficits—saw essentially no gains in employment and wages over the past 18 months. To compensate for this poor wage growth, households increased their borrowing. Now burdened with growing debt, households ultimately have curtailed consumption to avoid bankruptcy.

The lack of demand is not limited to industrialized economies. The frequency and severity of financial crises in emerging economies grew with increased liberalization (Weller 2001). Many emerging economies have implemented a mix of deflationary macro policies, often to appease lenders such as the World Bank and IMF, in the wake of financial crises. These policies consist of higher interest rates, the elimination of budget deficits, and structural changes (especially the deregulation of many markets, including labor). Increased labor market flexibility tends to lower labor income, leading to less consumption. In turn, this slowed consumption often exacerbates the problems created by the financial and economic crises, keeping economies from growing faster for lengthy periods of time.

Labor standards and economic growth

The bulk of the economic research on worker rights shows that these labor standards are associated with significant increases in economic growth in the nations that have implemented and enforced them. In

particular, child labor, forced labor, labor market discrimination, and legislation barring unionization or collective bargaining all inhibit productivity growth.

In theory, child labor and forced labor increase the supply of cheap or free labor within a country, driving down wages for everybody. Easy access to cheap labor removes incentive for firms to lower their costs by developing or adopting new technologies. Consequently, productivity growth is slowed. Furthermore, the fact that children are working in low-wage jobs instead of attending school will impede the growth of a nation's stock of human capital in the future, potentially inhibiting long-term productivity growth as well (Maskus 1997).

Economic theory also suggests that labor market discrimination may impede effective matching in the labor market between employers and workers. Economies are much more productive when jobs are allocated on the basis of skills and ability instead of ethnicity, gender, or caste (Acemoglu and Shimer 1999).

From a theoretical perspective, the right to form labor unions and bargain collectively has the greatest potential impact on economic growth. Unions give workers a direct voice to management, making it more likely that conflicts will be resolved through discussion rather than through employee separations (i.e., firing or quits). Unionization reduces turnover, making it more likely that employees will develop valuable job-specific skills and more likely that employers will invest in long-term training, both of which contribute to productivity growth.

The evidence shows that these growth-enhancing effects of worker rights are strong. Palley (1999) showed that, in the case of 15 developing countries, the adoption of CLS was positively related to higher rates of economic growth. Buchele and Christensen (2003; 2001) found that worker rights within the Organization for Economic Cooperation and Development (OECD) were positively associated with economic performance. A recent World Bank report (Aidt and Tzannatos 2003) showed that most studies on the issue find that coordinated collective bargaining was associated with improved macroeconomic performance in the 1970s and 1980s (evidence for the 1990s was mixed).

Table 1 provides some evidence on a sample of 17 nations that the OECD has identified as adopting labor standards over the past 20 years. On average, economic growth and growth in manufacturing has risen in nations after adopting CLS. Export growth has fallen, but this is, contrary to conventional wisdom, not necessarily a sign of weakness. Rather, it may signal the healthy re-orientation of these economies toward emphasizing domestic demand over exports, as is discussed further below in more detail.

Labor standards and income distribution

The evidence on the effect of worker rights on income distribution is even more powerful than their effects on growth. Besides making the economic pie larger, adopting labor standards also increases how equally the pieces of this pie are cut.

Worker rights give a voice to more people both on the company level as well as on the national level, providing a check to the narrow interests of economic elites. Thus, worker rights have a direct effect on how economic resources on the company level are distributed, and they have an indirect impact on the economy-wide distribution of national income. In either case, better worker rights should lead to a more equitable distribution of income.

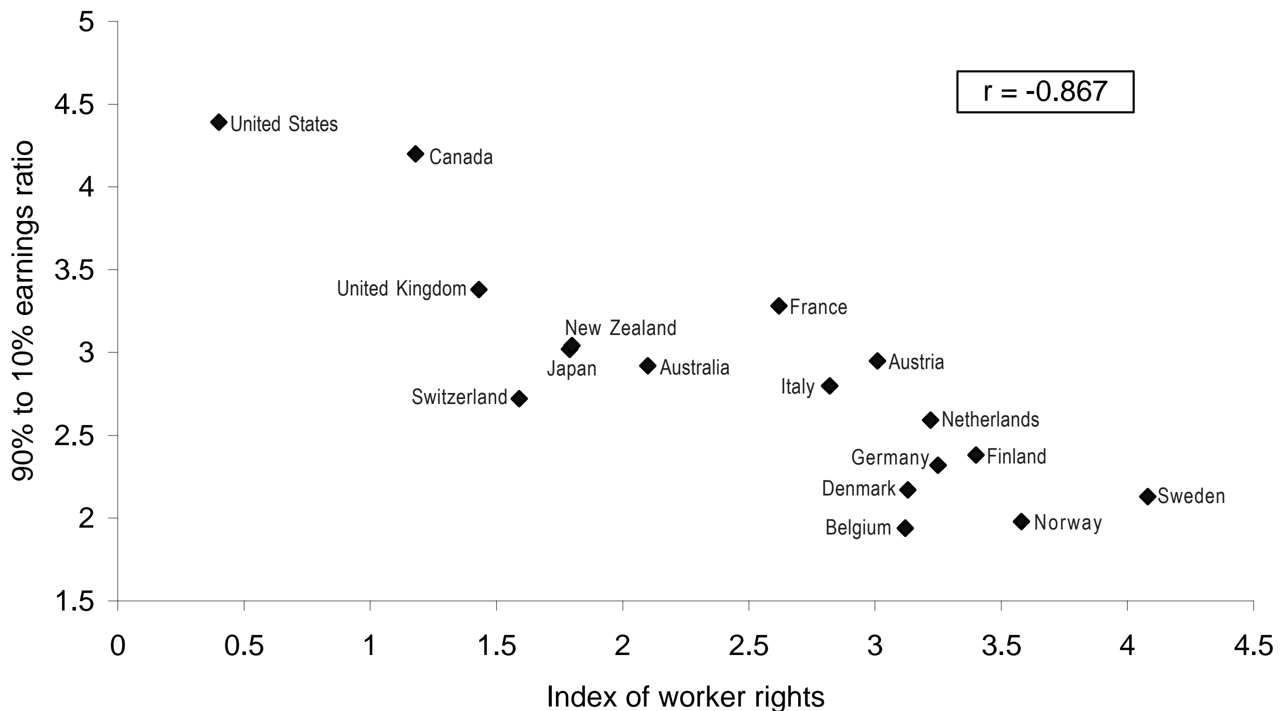
TABLE 1
Economic growth before and after the adoption of labor standards

		GDP growth		Manufacturing Output growth		Manufacturing Export growth	
		Before	After	Before	After	Before	After
Argentina	1983	-0.2	1	-0.5	0	0.6	2.8
Brazil	1988	5.3	0.9	4.5	-2.2	9.5	4.8
Dominican Republic	1990	4.4	4.5	1.7	4.2	9.1	5.6
Ecuador	1979	7.1	1.3	11.6	2.1	0.4	2.3
Fiji	1987	9.8	5.8	4.2	-0.6	14.3	6.7
Guatemala	1992	4.1	4.1	-	-	5.6	8.6
Honduras	1990	3	3.3	4	3.8	1.9	1.8
South Korea	1987	10.7	8.6	15.7	8.3	15.6	6.9
Panama	1989	-0.5	10.5	-2.5	8.9	0.2	8.9
Peru	1990	-0.9	1.8	-	-	-3.8	-23.2
Phillipines	1987	-1.3	4	-2.4	3.1	2.4	7.2
Suriname	1991	1.7	0.6	-3.2	-2.4	-	-
Taiwan	1987	9.6	6.9	-	-	-	-
Thailand	1992	10.7	8.2	14.7	11.5	17.3	13.2
Turkey	1986	6.1	2.7	7.9	5.7	16.1	8.1
Uruguay	1985	-7.6	4.4	-5.4	3.7	2.7	6.8
Venezuela	1990	2.7	5.2	-3.3	4.5	6.8	3.6
Average		3.81	4.34	3.36	3.61	6.58	4.27

Source: OECD (1996).

The empirical evidence supports this view. Rodrik (1998) showed in a study of over 100 nations that countries with more political freedoms pay wages that are 10-20% higher than in less free countries. For instance, a country like Mexico could realize average wage gains of 10-40% were it to attain a level of political freedom similar to that found in the United States. In comparison to other policies recommended by the IMF, studies sympathetic to trade liberalization found that complete removal of all trade barriers in the world will provide Mexico an average wage increase of less than 2% (Brown, Deardorff, and Stern 2001). Palley (1999) showed that adoption of CLS is associated with a significantly more equal distribution of income. And Aidt and Tzannatos (2003) stressed that union density and bargaining are positively correlated with more equal earnings distributions. Additionally, Alesina and Rodrik (1994) pointed out that more equal income distribution is, in and of itself, correlated strongly with improved economic performance. Labor standards, then, help spark a virtuous circle of equality and economic growth.

Buchele and Christiansen (2003) found a similarly striking correlation between an index of worker rights and income equality in a sample of OECD nations. The vertical axis in **Figure 1** shows the ratio of earnings of the top 10% of earners to the earnings of the people with the lowest 10% of earnings. The horizontal axis shows an index of worker rights constructed by Buchele and Christiansen (2003), which is based on information about the strength of employment protection laws, the scope of union density and



collective bargaining agreements, and income security and social protection. Enhanced worker rights are strongly correlated with more equal incomes, as the correlation coefficient of –0.87 (out of a possible –1) suggests.

Labor standards, crisis avoidance, and recovery

Given the first round of crises in Latin America in the early 1980s, the Asian crisis of 1997-98, and Argentina's present financial-market-induced depression, it is now generally accepted that financial crisis avoidance and recovery are some of the most important tasks facing policymakers in developing nations.

Research has shown that the poor are particularly vulnerable to the effects of financial crises. Lustig (2002) asserts that "crises not only result in higher poverty rates, but also may cause irreversible damage to the human capital of the poor....The poor are particularly vulnerable to negative shocks for a variety of reasons." A recent World Bank report (1999) reinforces this finding that economic insecurity (unemployment and variability of employment and wages) ranks high among the concerns of the poor.

A range of macroeconomic and financial policies can help developing nations avert crises (Blecker 1999). One important recommendation is for countries to emphasize strengthening policies that could boost domestic demand (Blecker 2000; Palley 2000). Nations that pursue policies that would enhance

domestic demand are less subject to external shocks. Furthermore, firms are less likely to build up too much capacity if domestic demand is stronger. Problems of overcapacity, often driven by "easy money" fuelled by capital inflows, is usually at the core of financial crises. Investors eventually decide that their profit expectations cannot be realized, leading to capital withdrawal and bankruptcies.

A key ingredient to strengthen domestic demand is strong growth that is equitably distributed. Wage earners, especially at the low end of the wage scale, spend more of their incomes than affluent owners of capital, a trend that is obviously accentuated when overall economic growth is strong. Equitable distribution of growth provides a stable, robust component to domestic demand, allowing domestic producers to make long-term plans and produce sufficient output to expand and make productivity-enhancing investments.

Recent work by Weller and Singleton (2002) showed that political freedom—including labor standards—is an important determinant of financial stability. Banking and currency crises were much less likely to occur in those nations that have made strong commitments to adopting and enforcing worker rights. Despite the many intermediating factors at play between labor standards and financial stability, the relationship between the two is robust and significant. A measure of civil liberties ranging from 1 (least free) to 7 (most free) produced by Freedom House (2002) found that moving one rung further up the index reduces the probability of a currency crisis by 22%.

The evidence also shows that the severity of crises, if they occur, was muted in countries with better worker rights. After the Asian currency crisis of 1997-98, South Korea fared relatively well in its recovery, while Indonesia fared particularly poorly. Rodrik (1999) found that institutions promoting democratic rights, rule of law, and social safety nets are an important factor in enabling nations to rebound more quickly from economic shocks. Lustig (2002) similarly found that the existence of decent social safety nets is one of the most important crisis-recovery policies a nation can adopt. But democratic rights and social safety nets are much more likely to exist in nations where worker rights are respected and where labor has a voice in governance.

Conclusion

Many globalization critics have pointed to a lack of concern for worker rights. Worker rights are not a luxury to be obtained only after some ill-defined threshold of development; rather, they are crucial in putting nations on a sustainable path towards strong and stable economic growth. Worker rights can even provide some protection from financial crises and enable economies to rebound quicker if a crisis does occur.

The detailed analyses that have been performed to date are clear: worker rights encourage growth, help distribute the fruits of growth more equally, and are a core component of economic crisis avoidance and recovery. As such, they should be part of the official "rules of the game" regarding globalization.

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Endnote

1. Throughout this brief we use worker rights to indicate *de facto* rights that workers have, while labor standards denote legal commitments that may or may not translate into better worker rights

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