Union rights – a competition factor?

If union rights are strengthened, do they weaken a country's competitiveness and attractiveness to foreign investors? And does this put the fight against poverty at risk? Recent research suggests that strong union rights and democracy produce more benefits than disadvantages for the world's poorer economies.

David Kucera
Senior Research Officer
International Institute for Labour Studies
ILO

A key aspect of the debate on trade union rights and poverty addresses the effects of these rights on developing countries' comparative advantage, particularly as regards international trade competitiveness and attracting foreign direct investment (FDI). That is, concerns about trade union rights and poverty are commonly viewed in the context of globalization, particularly the globalization of markets for goods and capital.

From the viewpoint of many developing countries, these global markets offer the potential of contributing to economic growth – defined as a rise in average incomes per person. It should be emphasized that the extent of poverty in a country is basically determined by two things: the average income per person and how that income is distributed. Therefore, for any given scenario of income distribution, higher average income per person in a country means less poverty in that country. Looking at this over time, more rapid economic growth means more rapid poverty reduction. The commonly expressed concern regarding trade union rights is that strengthening such rights will weaken developing countries' comparative advantage regarding their export competitiveness and in attracting FDI, thus hindering their economic growth and poverty reduction.[1]

There are two main reasons for this concern. The first is the widely held view that developing countries' comparative advantage lies in their having low labour costs. This is based on the idea that a country's comparative advantage is determined by its relative proportions of land, labour and capital (the Heckscher-Ohlin principle) and that developing countries tend to have high relative proportions of labour relative to capital. Therefore, developing countries are argued to have a comparative advantage in the production of such labour-intensive goods as clothing, footwear, leather goods, toys and furniture.

Second, it is argued that stronger trade union rights will tend to lead to higher labour costs for the employment of union members and, depending on the character of industrial relations and spillover effects, of non-union members as well.

Supporting this view are statistical studies which have found that stronger trade union rights across countries are associated with higher wages, even after accounting for other determinants of wages, labour productivity being the most important of these. That is, even though stronger trade union rights may tend to increase labour productivity, the evidence suggests that they tend to increase wages somewhat more. This means that there is a shift in a country's aggregate income from profits to wages. Putting these two factors together, therefore, leads to the concern that stronger trade union rights might weaken countries' comparative advantage as regards international trade and FDI.

It should be said from the outset that this is a rational enough view, which perhaps explains its persistence. The problem, however, is that it is fundamentally incomplete. It focuses solely on the possible negative effects of stronger trade union rights through higher labour costs and neglects possible important positive effects.

For instance, trade union rights essentially represent democracy for workers, and there is a strong relationship between stronger trade union rights and stronger democracy in the country as a whole. And democracies tend to perform quite well economically, particularly as regards economic stability. Summarizing his research on these issues, Harvard economist Dani Rodrik writes: "1. Democracies yield long-run growth rates that are more predictable. 2. Democracies produce greater stability in economic performance. 3. Democracies handle adverse shocks much better." (1997). These positive economic aspects of democracy hold even though workers in more democratic countries tend to receive higher wages relative to their productivity. Let us next explore these issues in greater detail as regards first, FDI and second, trade competitiveness.

Foreign direct investment

Regarding FDI, countries with stronger trade union rights tend to have better country credit risk ratings, and these ratings are used by international investors to determine investment locations. Suggestive in this regard is a recent survey of several hundred "managers of transnational corporations and international experts around the world", who assigned scores ranging from 0 (not important) to 5 (very important) to thirteen factors determining the country in which they will undertake FDI. These factors are ranked in order of importance, most to least, as follows, with the score given in brackets:

1. Growth of market (4.2)
2. Size of market (4.1)
3. Profit perspectives (4.0)
4. Political and social stability (3.3)
5. Quality of labour (3.0)
6. Legal and regulatory environment (3.0)
7. Quality of infrastructure (2.9)
8. Manufacturing and services environment (2.9)
9. Cost of labour (2.4)
10. Access to high technologies (2.3)
11. Fear of protectionism (2.2)
12. Access to financial resources (2.0)
13. Access to raw materials (2.0).

Note that the two highest-ranked factors are "growth of market" and "size of market," both of which represent market potential. This indicates that the most important reason for FDI is to sell the goods in the countries in which they are produced. This leads to an important distinction between types of FDI.

Some FDI is for the production of goods that are then shipped to other countries. Such FDI attempts to take advantage of lower labour costs, with export processing zones being the classic example. But much FDI represents rather an alternative to exporting to a country and is intended to gain access to markets. For such FDI, there is a beneficial side to having higher wages, since this increases the market potential for the goods produced. For example, if an automobile manufacturer sets up a factory in a country in order to sell cars there, higher overall wage levels increase the number of workers who can buy these cars (or the number of cars they can buy). In this sense, stronger trade union rights and higher wages create a positive incentive for investing in a country.

Note also in the survey that "political and social stability" ranks fourth and "cost of labour" is well down the list, ranked ninth. These survey results suggest that if stronger trade union rights are associated with higher labour costs – a negative for FDI – but also with greater stability – a positive for FDI – the positive effects may well offset the negative. Therefore, stronger trade union rights do not necessarily have a negative effect on attracting FDI. This depends on the relative strength of the positive and negative factors.

Statistical analyses of these issues show, in fact, that stronger trade union rights do not have a negative effect on FDI, suggesting that the positive effects offset the negative effects of stronger trade union rights. This result holds even if we only look at developing countries. These countries are of particular relevance, given that their comparative advantage in attracting FDI is argued to depend on their low labour costs and that a higher share of FDI in these countries attempts to take advantage of low labour costs. One can, of course, point to cases where foreign investments are not made or are withdrawn because of the strength of trade unions. In general, however, the empirical evidence suggests that these cases are not generally representative.

It is worth emphasizing that these statistical analyses do not simply look at whether countries with stronger trade union rights receive more or less FDI. This would provide an incomplete and inaccurate picture of the relationship between trade union rights and FDI. For there are many factors determining FDI, as the above-noted survey suggests, and these must also be accounted for.

If there were no such other factors, then all FDI would simply go to the country with the worst trade union rights and lowest labour costs, and that of course is not what happens. To take an illustrative example, it is commonly noted that a handful of East Asian developing countries receive a large share of the FDI going to developing countries and that a number of these countries have weak trade union rights. However, these countries also have enormous market potential, as indicated both by their rapid economic growth and by the large numbers of people living there. People in these countries also tend to have relatively high levels of education, providing a skilled workforce. (Note that "quality of labour" ranks fifth in the above survey.) Therefore, much FDI into these countries results from these and other factors that are not directly related to trade union rights.

As regards FDI, there are two bottom lines, one conceptual and the other empirical. First, one should not have a clear expectation that stronger trade union rights would lead to either more or less FDI. This depends critically on the extent to which positive effects of stronger trade union rights (particularly through enhancing economic and social stability) offset negative effects (particularly through higher labour costs relative to labour productivity), which in turn depends on the type of FDI. The debate on these issues tends to focus on the negative effects at the expense of the positive effects. The second bottom line is that empirical studies, and there are several, show that stronger trade union rights do not in general negatively affect FDI.

Trade competitiveness

More prominent than the debate on FDI has been the debate on trade union rights and international trade. The perception that countries with greater trade competitiveness tend to have weaker trade union rights may result from the greater visibility of goods from these countries. Most obvious are the competitive successes of a number of East Asian countries having comparatively weak trade union rights.

However, in order to know whether there is a general association between weaker trade union rights and greater trade competitiveness, one must also include in one's purview countries with weaker trade union rights whose goods are less visible because they are not well integrated into international markets. That is, one must evaluate a representative sample of countries, especially given that there exist marked regional patterns of strength of trade union rights and trade competitiveness. This suggests the potential value of cross-country statistical studies of the determinants of trade competitiveness, evaluating as full a sample of countries as possible.

One recent study of the effects of trade union rights and democracy on international trade is characterized by having 162 countries in the sample, using four definitions of labour-intensive manufacturing industries and using a wide range of indicators of trade union rights. Starting with total trade, this study finds a clear result that stronger trade union rights are associated with higher total manufacturing exports and that stronger democracy is associated with higher total exports and total manufacturing exports. These results are consistent with the view that stronger trade union rights and democracy enhance export competitiveness, not hinder it.

These results might seem surprising, given the highly visible export successes of a number of countries where trade union rights and democracy are relatively weak. Certain East Asian countries spring to mind. The value of cross-country analysis, though, is that it tells us whether the experience of these countries is representative in this regard. Results of this study for total trade and total manufacturing trade suggest, rather, that the East Asian experience is anomalous in the broader global context. For one must also be mindful of the less visible export failures of a great many countries having weak trade union rights and democracies and indeed that such countries are among the most weakly integrated into global markets.

While such cross-country analysis is useful in determining representative patterns, it is of less help in understanding why these patterns occur. The result showing a positive correlation between stronger trade union rights and democracy and stronger export performance begs explanation. This is particularly so in the light of the findings of prior studies that stronger trade union rights and democracy are associated with higher wages, even after accounting for labour productivity and other wage determinants. For one would expect that higher wages would have a negative impact on exports, all else being equal, particularly for exports of labour-intensive goods.

Consistent with this expectation, the study does not find such a consistent positive correlation for labour-intensive goods with respect to trade union rights, though it does with respect to democracy. The study finds, in fact, a very strong relationship between stronger democracy and higher labour-intensive exports. This is consistent with the view that democracy is beneficial for the export performance of labour-intensive manufactures.

The study finds that there is essentially no relationship between trade union rights and labour-intensive exports. The less positive relationship for labour-intensive manufacturing exports than for total manufacturing exports is consistent with the expectation that labour-intensive industries are particularly sensitive to higher wages resulting from stronger trade union rights. The idea that the comparative advantage of developing countries depends on low labour costs might suggest that stronger trade union rights are of particular concern for developing countries' export competitiveness. However, the study does not find solid evidence that stronger trade union rights have an adverse impact on the exports of labour-intensive manufactures, but rather that there is essentially no relationship.

It is worth emphasizing, too, that the exceptional export performance of the developing East Asian countries holds right across the range of manufacturing industries. In other words, for both labour-intensive and capital-intensive industries and for those in between. Thus, if poorer developing countries seek to emulate this pattern of diversified success, what matters is the relationship between total manufacturing exports and trade union rights.

Taken together, the results for total manufacturing trade and labour-intensive manufacturing trade suggest that the positive effects of stronger trade union rights and democracy offset the negative. There is, in fact, stronger evidence that trade union rights contribute to export competitiveness than that they hinder it, and such export competitiveness may in turn lead to economic growth and poverty reduction. The positive effects of stronger trade union rights may be related to the greater economic and social stability enjoyed by countries with stronger trade union rights and democracy, with such stability in turn facilitating export competitiveness. This is, however, a hypothesis that requires further exploration, which could be usefully performed through such qualitative approaches as country case studies.

It should be noted, too, that economic and social stability are desirable in and of themselves and are particularly important for the poor, whose welfare is particularly vulnerable in the face of such instability. This suggests a quite direct benefit for the poor from stronger democracy and trade union rights.

Note

[1] Though it is beyond the scope of this article, there is an important debate about the extent to which FDI contributes to economic growth and therefore poverty reduction. It may often be the case, for instance, that FDI follows, rather than leads to, economic growth.

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