

edge that using trade sanctions to raise this second group of standards could seriously reduce world trade and may actually hurt the very people it aims to help.

Countries that do not respect core standards pose a serious dilemma for the international community. Trade sanctions against them could be justified on moral grounds—and on economic grounds, for example because free trade unions bargaining collectively with employers can help ensure that labor conditions reflect the country's income level. However, such sanctions will hurt the entire global community and not just the country in question, and the cost to the rest of the world will rise with the offending country's size and importance. There is a risk that sanctions will only be applied to small countries, while large violators of basic rights go unpunished.

The real danger of using trade sanctions as an instrument for promoting basic rights is that the trade-standards link could become hijacked by protectionist interests attempting to preserve activities rendered uncompetitive by cheaper imports. The history of antidumping—the practice of retaliating against countries that sell their goods in another country's market at a price below their production cost, or below the price in other markets—shows that discretionary trade protection, even when both rational and well-intended, is highly vulnerable to misuse. Low-cost unskilled labor is the main comparative advantage of poor countries. Differences in endowments are the very basis of international trade and, as was argued in Part Two of this Report, are not a source of general declines in employment in richer countries—even though they may contribute to

changes in employment structure and contraction of employment in certain activities. Where jobs are lost, there is a case for public action, but trade protection is a blunt instrument, taxing others in the society and delaying the structural change that will be the foundation of future growth and jobs.

•••

Because the formal sector is typically very small and enforcement capacity weak, labor standards in many low- and middle-income countries apply either only to a fraction of the labor force, or not at all. Needy workers in those countries often are not reached by protective labor legislation. They benefit from public action that attempts to improve the working environment in the rural and informal sectors—for example, through the provision of drinking water, improved sanitary conditions, or eradication of infectious diseases. This does not mean that governments should not try to set standards for formal sector workers. But standards that aim at protecting the vulnerable or those who face discrimination—for example, bans on child labor or equal-pay legislation—need to be complemented by other actions such as subsidies for education or greater access for women to modern sector jobs. Health and safety standards can also improve workers' welfare, but compliance increases when it is monitored by labor unions or other civic organizations. Minimum wages may be useful under some circumstances in industrial countries, but they are difficult to justify in low- and middle-income nations. And the costs of trying to link national labor standards to international trade relations will almost certainly outweigh any benefits.

## CHAPTER 12

# The Role of Unions

**F**REE TRADE UNIONS ARE A CORNERSTONE OF any effective system of industrial relations that seeks to balance the need for enterprises to remain competitive with the aspirations of workers for higher wages and better working conditions. Unions act as agents for labor, organizing large numbers of workers into a single entity whose collective bargaining power matches that of the employer. Trade unions can also monitor employers' compliance with gov-

ernment regulations (Chapter 11), and they can help raise workplace productivity and reduce workplace discrimination. They have a noneconomic role as well—some unions have contributed significantly to their countries' political and social development. Nations that, usually for political reasons, limit the freedom of unions to organize and operate are left without a mechanism that allows workers and firms to negotiate wages and working conditions equitably. The result has tended to be excessive intervention and reg-

ulation as governments try to pacify workers and gain support for state-controlled unions. But unions can also have negative economic effects. In some countries they behave as monopolists, protecting a minority group of relatively well-off unionized workers at the expense of the unemployed and those in rural and informal markets, whose formal sector employment opportunities are correspondingly reduced.

On balance, do free trade unions help or hinder the functioning of labor markets? This chapter examines the economic and political roles of labor unions and identifies the legislative and broader economic framework under which unions work best.

### The economic role of unions

There are two very different views about the economic impact of labor unions. Supporters see them as giving workers a collective voice and enhancing productivity and equality. Opponents see them as monopolists, limiting employment in order to raise members' wages. Do economic analyses and country experiences allow us to make such generalizations? The answer is no. Unions can have positive or negative effects, depending upon the incentives they face and the regulatory environment within which they operate.

#### *Positive effects*

**IMPROVED PRODUCTIVITY.** Trade union activities can be conducive to higher efficiency and productivity. Unions provide their members with important services. At the plant level, unions provide workers with a collective voice. By balancing the power relationship between workers and managers, unions limit employer behavior that is arbitrary, exploitative, or retaliatory. By establishing grievance and arbitration procedures, unions reduce turnover and promote stability in the work force—conditions which, when combined with an overall improvement in industrial relations, enhance workers' productivity.

In many jobs workers are better informed than management about how to improve productivity. They will be more willing to share this information if they are confident of benefiting from any resulting change in organization. The presence of an agent on the workers' behalf, the union, may make them less suspicious that any information they reveal will benefit only management. If the union involves workers in activities that improve efficiency, unionism can be associated with a more productive organization.

Working conditions in some enterprises exhibit the characteristics of nonrival public goods: their "consumption" by one worker does not reduce their availability to another. Job safety is an example. Workers could shop for the level of workplace safety they want by changing jobs until they find one whose conditions suit them, but frequent worker turnover is inefficient and costly for employers as well as for labor. Those costs can be avoided by a union that efficiently communicates workers' preferences.

There are very few studies of the relationship between trade unions and productivity in low- and middle-income countries, but a recent analysis of Malaysian data provides some support for the view that unions can enhance productivity and efficiency (Table 12.1). Unionized Malaysian firms tended to train their workers more and to use job rotation to enhance flexibility and efficiency. They were also more likely to adopt productivity-raising innovations relating to technological change, changing product mix, and reorganization of work.

**INCREASED EQUALITY AND REDUCED DISCRIMINATION.** Trade unions tend to increase wage disparities between union and nonunion workers, but they usually push for greater wage equality for their own members. When union members are women or belong to ethnic minorities, unions also fight against discrimination. Although sometimes desirable, the compression of wage differences due to union activity may reduce efficiency, by sending wrong signals to

### *Unionized firms in Malaysia stress the importance of raising productivity.*

**Table 12.1** Effect of unionization on productivity-enhancing initiatives by firms in Malaysia (percentage of firms taking action indicated)

Type of firm	Implementation of job rotation policy <sup>a</sup>	Reorganization of work	Upgrading of technology	Extension of product range
Plant union	30	29	40	20
Industrial union	31	32	37	26
Nonunion	22	18	26	20

a. Firms with more than 1,000 workers only.

Source: Standing 1992.

workers about which skills are most needed and which industries and occupations have the highest productivity.

The reduction in wage dispersion within unionized firms is well documented for industrial countries, and there are indications that the same effect occurs in low- and middle-income countries as well. A study in the Republic of Korea in 1988–90 found that unions there placed great value on wage equalization and that the degree of wage dispersion in the unionized sector was 5.2 percent lower than in the nonunionized sector. In Mexico union action appears to have helped reduce discrimination. A study using wage data for 1989 concluded that, in the nonunion sector, men enjoyed a 17.5 percent wage advantage over women with identical skills and experience, but the study found no significant wage differential between men and women in the unionized sector. Similarly, the study found a significant wage disadvantage for indigenous peoples in the nonunionized sector but no discrimination in firms covered by trade unions.

#### *Negative effects*

**MONOPOLISTIC BEHAVIOR.** Unions do often act as monopolists, improving wages and working conditions for their members at the expense of capital holders, consumers, and nonunion (unorganized) labor. The higher wages unions win for their members either reduce business profits or get passed on to consumers in the form of higher prices. Either result leads unionized firms to hire fewer workers, increasing the supply of labor to the unorganized sector and depressing wages there. The size of the union wage effect—the difference in compensation between otherwise similar workers that is attributed to union membership—has been studied in several countries. Results indicate that it can reach up to 31 percent in developing countries, 10 percent in Europe, and around 20 percent in North America (Table 12.2).

Where wages for the relatively few workers who are unionized are pushed up, the actions of unions can adversely affect the distribution of income. In most developing economies only a small fraction of the working population belong to trade unions. For example, union coverage is less than 4 percent of the labor force in Pakistan, 5 percent in Kenya, and 10 percent in Malaysia (Figure 12.1). In such settings unions can play an important role in determining pay differentials between workers in the small formal economy and the vast informal and rural working population. If the formal economy is unionized, the distributional outcome is likely to be regressive. Where formal sector production also enjoys trade protection, unions are likely to share the spoils with capital holders at the expense of consumers and the masses of workers in the nonunionized sectors.

But the existence of a union wage premium is not always proof of negative distributional effects, even in developing

***Unions are usually able to raise their members' wages above levels prevailing in the overall labor market.***

**Table 12.2 Union wage premiums in selected countries**

Country	Year	Estimated difference between union and nonunion wages (percent)
South Africa <sup>a</sup>	1985	10–24
Mexico	1989	10
Malaysia	1988	15–20
Ghana	1992–93	31
United States	1985–87	20
United Kingdom	1985–87	10
Germany	1985–87	5

a. Black unions only.

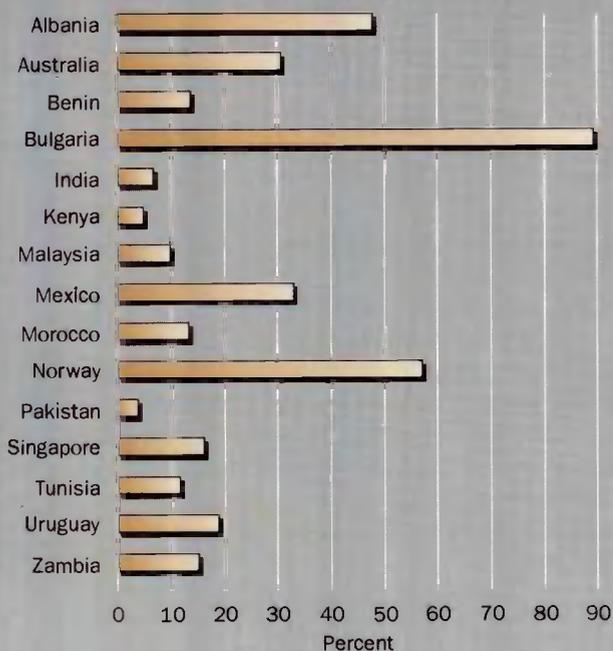
**Source:** Blanchflower and Freeman 1990; Moll 1993; Panagides and Patrinos 1994; Standing 1992; Teal 1994.

countries. The actions of black unions in South Africa implied a union wage premium of 10 to 24 percent in 1985. But by raising the wages of unionized black workers and bringing them closer to those of white workers, union action may have helped improve the distribution of income.

There are situations where the union wage premium is very small or even nonexistent. A 1991 study in Korea estimated that the wages of unionized production workers were only 2 to 4 percent higher than those of nonunion workers. Failure to detect a strong positive union wage differential is sometimes due to union influence extending beyond the unionized sector—there is often another relatively high-wage sector in the economy that is affected by the unions' wage-setting practices. Obvious examples can be found in some industrial countries, where the coverage of union agreements is automatically extended by law to nonunion workers—in Spain 75 percent of employees are covered by some collective agreement, although only 10 to 15 percent are union members. Where such laws do not exist, nonunionized firms are often under political pressure to pay union-negotiated wages, or they may choose to pay higher wages to head off unionization of their work forces.

**OPPOSITION TO REFORM.** Trade unions have sometimes wielded their political power against structural adjustment. India's unions continue to criticize the government's recent liberalization efforts, despite the apparent success of many of these initiatives since 1991. The unions have organized nationwide general strikes to oppose incipient industrial restructuring measures aimed in part at increasing India's outward orientation and the reform of state enterprises. India's unions are propping up the part of the economy most in

**Trade union membership rarely includes a majority of workers.**



**Figure 12.1 Union membership as a share of the labor force in selected countries.** Years vary by country from 1986 to 1995. Source: World Bank data.

need of reform. Latin America also has a long history of union opposition to adjustment. In the 1980s organized labor opposed such comprehensive reform programs as the Cruzado Plan in Brazil and the Austral Plan in Argentina.

### Improving the economic impact of unions

How can policymakers create an environment that minimizes the negative effects trade unions can have, while encouraging them to make a positive contribution to economic growth and equity? Experience indicates that such an environment will usually include competitive product markets and regulatory and institutional frameworks designed to protect workers' freedom of association and organization, including their right to join the union of their choice or not to join any union. Many countries' regulations also seek to support the process of collective bargaining in the private and the public sector.

#### *Encouraging unions' positive contributions*

**COMPETITION ON THE OUTPUT SIDE.** Competitive product markets limit unions' ability to obtain higher wages for their

members. Raising wages would force unionized establishments out of business unless the higher wages could be justified by increased productivity. In less competitive environments unions will attempt to capture economic rents and will ally themselves politically with their employers and with politicians who promise to perpetuate those rents. This kind of behavior is evident in industrial countries, where union wage premiums are greatest in regulated sectors and in concentrated industries. In many countries union opposition to trade liberalization and privatization is a rational strategy for maintaining higher wages for unionized workers in the short run at the expense of nonunion workers. Promoting domestic competition and openness to international markets will therefore help curtail these negative effects.

**LABOR REGULATIONS AND THE SYSTEM OF INDUSTRIAL RELATIONS.** The structure of union organization and the coverage of collective agreements condition union behavior. A key principle in industrial relations is to ensure that the parties engaged in bargaining absorb the costs of their actions rather than shift them to third parties. But in some countries legislation requires that workers be paid even when they are on strike—a clear disincentive to compromise. In contrast, many governments refrain from providing loans or deferring tax payments for firms during strikes or lockouts. Negotiations between unions and public enterprises show starkly how unions are able to achieve distorted outcomes when third parties bear the cost of negotiated agreements. If a public enterprise can turn to the government for subsidies or easy credit when it is in financial difficulty, or if its monopoly status allows it to raise prices at will, the burden of high settlements falls on those who pay the resulting higher prices or higher taxes, not on the workers or the enterprise managers who negotiated the increase.

Legislation in many countries stipulates the right to join a union of one's own choice as a basic human freedom. This is the legal foundation for the emergence of unions that are free and independent. Such unions are able to act as genuine representatives of workers and thus to bargain with employers to the extent that the competitive environment allows. Such legislation usually allows more than one union to be established to represent a given group of workers; this is a strong incentive for established unions to maintain the quality of their services. Legislation of limits on the number of unions per enterprise is viewed as an infringement on workers' rights. Union fragmentation and interunion rivalry are sometimes disruptive, however, and bargaining costs rise if workers have many representatives. These issues are often dealt with through cooperation, with employers offering unions incentives to join together for bargaining. Freedom of association also encompasses the right not to be forced into a union. In economic terms, a competitive nonunion labor market could exert discipline on the mo-

nopolistic wage practices of unionism. If, however, the state encumbers the nonunion sector with regulations on minimum wages and restrictions on hiring and firing, the sector will operate much less effectively as a constraint on unions' wage demands.

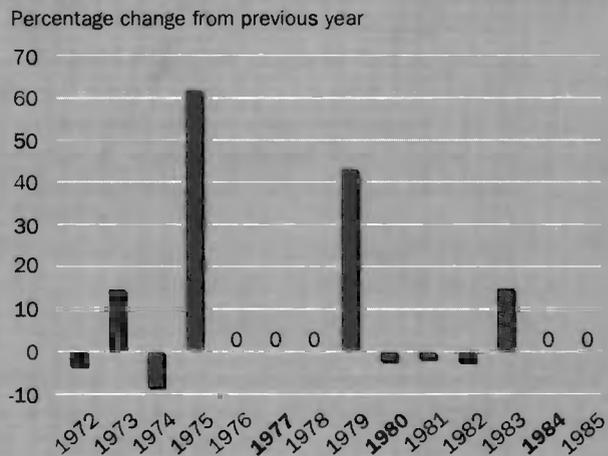
The importance of competitive output markets and of the principle of internalizing bargaining outcomes is illustrated by two contrasting examples. A survey of twenty industrial firms in Brazil found that increased competition in the output market caused those firms to introduce productivity-enhancing techniques and processes such as quality controls and quality circles. Labor, keen to ensure continued competitiveness, did not insist on past privileges but instead cooperated with management in this process. This indicates that there is more to industrial relations than bargaining over wages and other conditions. In many countries labor and management get together to consider ways of increasing competitiveness. Coal miners in India, in contrast, have been shielded from competition ever since the government takeover of the industry in 1973. The highly unionized coal workers exert political pressure to obtain wage increases that are unrelated to market realities. As a result, their wages have been mainly based on political considerations, without regard to the country's economic interests and development objectives: the real wages of coal miners have jumped noticeably in the years just before national elections (Figure 12.2).

#### *Collective bargaining in the private sector*

THE LEVEL AT WHICH BARGAINING TAKES PLACE. The experience of several countries indicates that bargaining at the enterprise level can be an appropriate framework for achieving positive economic effects. At the other extreme is bargaining at the national level, common in Northern and Western Europe. Although these systems have fallen out of favor as Europeans grapple with rising unemployment and inflexible labor markets, they are associated with decades of positive industrial relations and good wage and employment outcomes for European workers. But national-level bargaining requires that most workers be covered by union agreements. If they are not, as is the case in most countries, national agreements will benefit the unionized sector at the expense of the unorganized and poorer groups in society. That has been the result in Latin America, where centralized approaches to industrial relations have fared poorly.

If collective bargaining takes place at the enterprise or the plant level, the union's ability to effect monopolistic wage increases is tempered by the strong competitive pressures on the firm from the product market. In Malaysia it has been calculated that the wage premium for plant-level unions is around 15 percent, whereas sectoral, or industry-wide, unions are associated with a wage premium of nearly 20 percent.

#### **Indian coal miners have often seen their wages jump before national elections.**



**Figure 12.2 Real wages of coal miners in India.** Election years are indicated in bold type. Source: Banerji and Sabot 1993.

Examples of how decentralized bargaining can achieve good results are found in certain industrial countries (Canada, the United States, and Japan) and in some of the newly industrializing East Asian economies (Hong Kong and Korea after 1987). The system of collective bargaining in transitional economies is still being developed. In Canada and the United States collective bargaining is mostly at the enterprise level, although there are some multiemployer arrangements. There is no tradition of involvement by central organizations in bargaining in most sectors, and there are no central employer organizations. Enterprise unions have been heralded as one of the pillars of industrial relations supporting Japan's economic achievements. In Japan collective bargaining takes place at the enterprise level, but confederations of labor unions play an important coordinating role during the annual bargaining exercises. In Hong Kong unions are also organized along enterprise lines, although as in Japan there is some coordination by trade union federations. Hong Kong's unions operate in an environment of strong competition in the output market, as well as in the labor market because of migration from China. This weakens their bargaining position, and most unions are in the business of providing insurance and social assistance to their members rather than fighting for higher wages.

Recent developments in Korea's system of industrial relations provide useful lessons for other countries. Trade

union freedom increased as part of the process of political liberalization that started in 1987. The number of unions and their membership rose rapidly (Table 12.3). In 1992 Korea had 7,676 firm-level unions and 21 industrial federations. After a chaotic beginning, with conflict-ridden labor-management relations in 1987–89, collective bargaining is now becoming an established institutional arrangement. Bargaining is decentralized and is conducted at the enterprise level, except in a few cases, such as textiles and banking, where bargaining occurs at the industry level or through a multiemployer arrangement. Korean industrial relations are still evolving, but the tradition of enterprise-level bargaining has not been significantly modified in the new collective bargaining experiments since 1987, and a restructuring of bargaining patterns appears unlikely in the near future.

The system of industrial relations in the countries of Eastern Europe and the former Soviet Union is also still evolving. Transitional economies inherited heavily unionized labor markets, with more than 90 percent of workers belonging to unions sponsored and supported by the state and the communist party. Economic and political transformation has led to a decline in union membership, even as unions were gaining their independence. But unionization—estimated in 1990 at around 80 percent in Russia and 60 percent in Poland—remains much higher than in most high-income industrial or developing countries. Unions in transitional economies are still trying to adapt to new realities and to develop their own approach to bargaining. Experiences have been mixed. Countrywide bargaining between unions and employers in the Czech Republic—a relatively small country with a tradition of coordination at the national level—appears to be achieving good results.

This was not the case in Ukraine, however, where centralized bargaining in 1993 led to an unsustainable agreement whereby wages rose faster than inflation.

That plant-level collective bargaining may be better suited to conditions in many countries does not mean that consultations at the sectoral or the national level should not take place, or that national trade union federations have no role. In nearly all of the country examples presented here, enterprise-level bargaining is complemented by sectoral or national coordination. And multiemployer agreements may under certain circumstances be more efficient than enterprise bargaining, as in the construction sector in some areas of the United States, where the nature of the work is such that workers change employers very often. Trade union federations can be important when large-scale structural adjustment and rapid disinflation are needed. In Israel and Mexico, organized labor rallied behind governments committed to adjustment programs and agreed to social pacts that have facilitated stabilization, but instances of this constructive role of labor confederations have been rare. It is difficult to persuade a powerful pressure group to help design and implement a stabilization plan, and eschew general strikes against restructuring measures aimed at increasing the outward orientation and privatization of industry, when the result is likely to be to reduce the relative wages of its members.

**SUPPORTIVE LEGISLATION AND THE ROLE OF EMPLOYERS.** Decentralized bargaining requires strong guarantees of union rights. A system of industrial relations based on enterprise-level unions can be open to abuse by employers. Some employers try to use their relative market power to discourage the organization of labor unions in their enterprises. Employer abuse can lead to deteriorating industrial relations and unrest, which are hardly conducive to investment and growth. Labor legislation must try to strike a difficult balance, protecting unions' rights while limiting their potential monopoly power.

The content of enterprise-level collective bargaining is usually determined by the parties themselves, obviating the need for legislation to spell out what contracts may or may not cover. If management is willing to enter into agreements about capital-labor ratios, apprenticeship programs, and the conditions under which temporary workers are hired, the law should not forbid it. In a competitive product market the costs of such agreements will fall mainly on the firm and the union, which should deter them from reaching unrealistic agreements.

Nor is there usually a need to legislate a limit of one union per enterprise. If management wants to minimize bargaining costs by having just one union to deal with, it is up to management to persuade the unions to join together for collective bargaining. Allowing other unions to form

*The number of Korean trade unions has risen sharply since 1987, with most organized at the firm level.*

**Table 12.3** Types of labor organization in the Republic of Korea

Year	Total	Industrial federations	Local branches <sup>a</sup>	Firm-level unions
1965	2,634	16	362	2,255
1975	4,091	17	488	3,585
1986	2,635	16	0	2,618
1988	2,742	16	0	2,725
1990	6,164	21	0	6,142
1992	7,698	21	0	7,676

a. Local branches were transformed into individual unions in the 1980 labor law revision.

Source: Krause and Park 1993. Reprinted with permission.

provides a check against an established union serving only the interests of a small group of workers. Alternatively, some labor regulations—for example, in Bangladesh—stipulate that only one union may act as a “collective bargaining agent” and call for the election of this agent from among all unions in the enterprise at regular intervals.

#### *Unions in the public sector and natural monopolies*

Ensuring that unions play a positive role is more difficult when they operate in noncompetitive markets, such as the public sector and natural monopolies (electric utilities, telephone companies, and others). The costs to society of an interruption of work by firefighters, police officers, teachers, nurses, utility workers, or public transport operators can be very high. Consumers have limited scope to look elsewhere for these services. As a result, a large part of the costs of a strike or lockout is borne by parties not represented in the negotiations.

The special features of labor negotiations in the public sector create a difficult dilemma. Should laws protect public sector workers’ rights to freedom of association and organization and their right to strike? Or should they protect the general public’s right to uninterrupted essential services and protect society from being held hostage by a small group of civil servants?

Societies’ responses to these questions vary. Public sector workers in Bangladesh are allowed to form unions but are not permitted to bargain collectively. Salaries and wages of civil servants and workers in public enterprises are determined by government-appointed commissions. However, this arrangement has not stopped public workers from going on illegal nationwide strikes to exert political pressure on the government to raise their wages. In Malaysia collective bargaining is allowed in the public sector, but the central government has the authority to accept or reject the final agreement—in addition, Malaysian public sector unions tend to be less independent from government pressures than unions in South Asia. Federal workers in the United States were denied the right to form unions until 1962, and even now they do not have the right to strike. In many U.S. states, state workers are also prohibited from going on strike. Spanish public workers, on the other hand, are allowed to form unions, bargain collectively, and strike, provided they continue supplying a minimum level of “essential services,” defined by law.

Dealing successfully with the problems raised by public sector unions depends upon the quality of labor legislation and dispute settlement procedures. Effective labor legislation for the public sector tries to set up alternative mechanisms to strikes and lockouts for the settlement of disputes—arbitration by third parties is an obvious example. Chile’s labor law provides for a special type of arbitration to deal with disputes involving public workers. Called “final

offer arbitration,” the arrangement requires the arbitrator to choose either management’s final offer or the union’s final offer. This encourages the two parties to present reasonable demands and thus to design their own contract.

#### **Unions and politics**

All pluralistic societies consider freedom of association and organization a basic human right, and organized labor is often in the vanguard of the movement toward greater political openness and democracy. But many countries still restrict trade union activities. How have constraints on freedom of association and organization affected labor market outcomes? In countries without free unions, collective bargaining is unavailable to determine wages and other working conditions; governments therefore perceive a need to intervene and set those conditions administratively. As a result, many countries that have repressed unions have had highly distorting labor policies.

Polish workers’ struggle for freedom in the 1980s was a dramatic reminder that free labor unions are mostly democratic institutions. Solidarity’s leaders believed that pluralistic labor unions could be the catalyst for a pluralistic political system and that free trade unions were a prerequisite for a free society. Negotiations in the city of Gdansk in August 1980, which focused on labor issues, led to the creation of the first free trade union in a communist country. But it quickly became obvious that authoritarian rule and a free trade union could not coexist: the communist leadership outlawed Solidarity in 1982.

South Africa’s black labor unions, like Solidarity, gave powerless people a chance to make their voices heard. Although the unions were concerned mainly with organizing workers to bargain over workplace issues, their political activities have received far more attention. The South African government’s original intention was to develop a pluralistic system of industrial relations that confined unions to workplace issues and left political issues to political parties. But South Africa’s experience also showed that free trade unions are inconsistent with nondemocratic practices—the black union movement became a leader in the struggle against apartheid.

Many governments continue for political reasons to exercise strict control over labor movements. Although a large number of nations have ratified Convention 87 of the ILO guaranteeing freedom of association and organization, its full application has proved elusive. Many countries deny workers the right to organize outside officially recognized and controlled structures. Responding to ILO inquiries, governments have given different explanations for this situation, not all of them convincing. A Nigerian government argued that its imposition of a single trade union center “responded to the desires of the workers to amalgamate the many trade unions and four central organizations which

had existed.” Egypt’s government sought to justify the trade union monopoly conferred by law on the Egyptian Trade Union Federation by declaring that it “represents the wish of the workers and corresponds to the needs of many countries, including developing countries.” And the Seychelles government told the ILO that the legal monopoly of the National Workers Union was established “after the voluntary dissolution of all trade unions.”

In the absence of free unions and collective bargaining, many governments feel obliged to reach out to formal sector workers through labor regulations and special privileges. This is particularly true when the government needs the political support of strong urban groups in order to remain in power. One result is that labor market distortions are particularly severe in many countries that repressed labor unions. Overstaffing in the public sector, high minimum wages, and restrictions on firing—policies introduced in Congo, Kenya, Sudan, Tanzania, and Zambia in the 1960s—reflected political realities for the governments that took power and repressed labor unions after independence. In Egypt in the 1950s and 1960s President Gamal Abdel Nasser, needing the support of the urban middle class, promised their children public sector jobs upon graduation from college. In Bangladesh during the 1980s General Hussain Mohammad Ershad, likewise needing the support of urban labor, negotiated with the country’s federation of

labor unions and agreed to increase public sector wages, severance pay, allowances, and nonwage benefits.

Not all countries that repressed unions adopted inefficient labor policies—Korea before 1987 is a notable example—and not all countries that allowed unions to operate freely had good labor outcomes. But the probability of governments passing inefficient labor legislation may be higher when workers’ right to representation is not protected. Empirical analysis finds that political liberties, which almost always go hand in hand with the freedom of unions to organize, are associated with less dualism in labor markets and a larger formal sector. Some East Asian countries both restricted union activity and achieved rapid growth in formal employment with only a moderate tendency toward dualism. But they appear to be exceptions.

• • •

Denial of workers’ rights is not necessary to achieve growth of incomes. It is possible to identify the conditions and policies under which free trade unions can advance rather than impede development. Unions are likely to have positive effects on efficiency and equity, and their potential negative effects are likely to be minimized, when they operate in an environment in which product markets are competitive, collective bargaining occurs at the enterprise or the plant level, and labor laws protect the right of individual workers to join the union of their choosing, or none at all.

## CHAPTER 13

# Dealing with Income Insecurity

**S**harp drops in income from work can have a profound impact on the living standards of workers and their families. Unemployment, disability, and old age are all important causes of poverty in industrial and developing countries alike, and of deeper poverty for those already poor. Dealing with these risks is particularly important in transitional economies. Most societies have developed ways of coping with the threat to living standards from both expected and unexpected falls in income. Often this involves

some combination of private saving, informal support mechanisms, and obligations on employers. Governments step in when these informal or private solutions prove insufficient. Households may find it difficult to borrow to cover temporary falls in labor income. Community support mechanisms break down when there is a community- or economy-wide shock, and they tend to decline with urbanization and the diminishing importance of the extended family. Private markets for unemployment and disability insurance and old age pensions are limited or absent, in