

Collective bargaining and income equality in an integrating world

Countries with strong collective bargaining institutions, including trade unions and employers' organizations, also have better income distribution. They enjoy more equitable and socially sustainable integration. Attempts to erode and weaken these institutions have been short-sighted and may even delay adjustment processes.

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Much of the recent debate on globalization has focused on the distributional consequences. Critiques of globalization argue that the benefits are unevenly distributed. There has been renewed emphasis recently on the role that institutions play in promoting successful integration into the global economy and more equitable patterns of development. Analysis of the potential benefits to be gained by globalization needs to include analysis of the institutions underlying growth and distribution. *Labour institutions* are among the many institutions that are important for growth and distribution.¹ The way in which labour participates in the production process, and the way in which the labour market is organized to determine the wage for that participation affects, amongst other things, distributional patterns.

The term *labour institutions* refers to those institutions that underpin labour markets and production. These include trade unions, employers' associations, collective bargaining practices, human resource practices, statutory regulations such as protection against unfair dismissal and labour market policies on training, minimum wages, etc. They vary in the degree to which they are formalized within law and policy. But whether their existence is

formally recognized or *de facto* the norm, these institutions shape the way in which workers participate in the labour market and in the production process. They may promote productivity, growth and more equitable patterns of participation and distribution, or reinforce patterns of exclusion and inequality.

The approach to these institutions and labour market policy in general during the 1980s and 1990s was one of deregulation and decentralization. Labour institutions, in particular trade unions, labour laws and wage-setting institutions, were blamed for creating rigidities and distortions in the labour market, ultimately slowing adjustment and putting a break on employment creation and economic growth.

Policy formulation was dominated by a strong neoliberal agenda that stressed the *allocative* function of labour markets (matching supply and demand) – a somewhat narrow view of the way in which labour markets function. There was little consideration of the role that labour institutions play in promoting *dynamic efficiency* (increasing the quality of labour and their participation in the production process) or in ensuring *social justice* through, for example, facilitating the equitable distribution of income.²

This article focuses on the role that *collective bargaining institutions* (both collective bargaining systems and trade unions) play in promoting more income equality in an integrating world.³

What is so important about collective bargaining?

Much of the debate in the 1980s and early 1990s focused on the performance of different *levels* of collective bargaining: centralized, decentralized or intermediate industry-level bargaining. Centralized or decentralized levels of bargaining were held to be superior to industry-level bargaining, in terms of employment, economic performance and equality.⁴ One of the weaknesses in the research was the specification of the variables used to measure the relationship between collective bargaining institutions and other variables.⁵ What emerged was that decentralized systems of collective bargaining could also be highly *coordinated* and thus also internalize the externalities of their actions – a key characteristic associated with centralized systems.

It is important here to clarify what is meant by *coordination*, and which “externalities” are taken into account in collective wage setting. The *coordination of collective bargaining* refers to the degree to which trade unions and employers’ associations coordinate wage agreements across the economy so that wages are non-inflationary, the wage bargain accommodates the macroeconomic implications of the wage settlement – such as inflation, unemployment and national competitiveness – and wages and profits are in line with competitiveness.

Thus, a key issue for the relationship between collective bargaining institutions, economic performance and income distribution is this institutional capacity to organize or *coordinate collective bargaining*. The most institutionalized examples of bargaining coordination are “social pacts”, where there is commitment to non-inflationary wage settlements in the context of a specific macroeconomic strat-

egy which includes benefits for labour in terms of employment creation, skills upgrading, social security, economic stability, and with growth, rising incomes. For example, in Ireland a series of national-level agreements have linked agreement on wage increases to agreement on economic and social policy.

Centralized bargaining systems (with centralized trade union and employer confederations) can be important coordinating institutions, in that they have greater influence over the level of wage settlements in the economy as a whole. But as noted above, multi-tiered, industry or decentralized plant-level bargaining systems may also function as coordinating institutions (internalizing the externalities of their settlements).

The actual coordinating mechanism in each system may differ. It may be formal or informal. Wages may be negotiated at an intermediate sectoral level, but with sufficient linkages across the economy (perhaps through a peak trade union or employers’ organization) to coordinate the level of wage settlements. Alternatively, one industry may be so dominant in an economy that it acts as a “lead bargainer” and signal for economy-wide settlements.

In decentralized bargaining systems, employers’ organizations, such as those in Switzerland or Japan, that operate through dense networks can be important institutions of coordination. Thus, the key variable to consider is not the level at which collective bargaining takes place, but the *degree of coordination* in any system. Of course, centralized systems also tend to be highly coordinated – but this is only one institutional manifestation of a highly coordinated system.

Promoting income equality

An important characteristic of collective bargaining institutions is that they can promote equitable patterns of income distribution. Countries with strong collective bargaining institutions, including

trade unions and employers' organizations, are also those countries with better income distribution (measured by the Gini ratio). Preliminary research using a sample of 41 countries for which data are available shows that the following categories of country all have better income distribution:

- countries where collective agreements cover more than 60 per cent of the population (see figure 1);
- countries where there is a high degree of collective bargaining coordination (see figure 2);
- countries with higher trade union density (see figure 3, sample size expanded to 69).

The relationships are also statistically significant (for collective bargaining coverage and trade union density) at the 5 per cent level. This is consistent with the literature that finds that highly coordinated centralized systems of collective bargaining are associated with less wage dispersion.⁶ For example, an OECD (1997) study found the relationship between cross-country differences in earnings inequality and bargaining structures to be robust and significant. That is, more centralized/coordinated economies have less earnings inequality than uncoordinated ones.

Globalization and economic integration do present external constraints to distributive policies in that increased competition makes it more difficult to either change prices or raise taxes. But this does not preclude redistributive strategies that rely on increasing productivity gains or redistributing income more equitably. Collective bargaining institutions can facilitate more equitable pay bargains, but they also can be productivity-enhancing, expanding the product available for distribution.

These labour institutions provide firms with the capacity to encourage participation in the workplace. The literature on the value of participation has examined benefits related to the ability to secure trust and commitment in employment relations and thus improve productivity and

efficiency.⁷ Indeed, there is a large body of evidence to show that participation at the workplace enhances company performance and that firms with higher degrees of worker participation outperform other firms.⁸ Participation at the workplace also reduces monitoring costs, with benefits in terms of efficiency. The potential to enhance efficiency and productivity raises other possibilities for distribution in the context of external pressures that place constraints on the wage bargain.

Some, however, argue that trade unions and collective bargaining institutions have a negative impact on income equality. According to this view, by negotiating a wage mark-up (the difference between union and non-union wages) trade unions increase income inequality. But in a more integrated world, the openness of economies and the intensification of product market competition have significantly reduced the possibility for firms simply to pass increases in labour costs (caused by unions' negotiating a wage mark-up) on to consumers by raising prices. However, there is also a need to address incentives in product and labour markets. This is considered in more detail in the next section.

Implications for the design of policy

In some countries, trade unions have been strong in activities enjoying significant rents, such as protected manufacturing sectors and the public sector. Product and labour market distortions have given rise to what economists call "rent-seeking" behaviour by trade unions. Firms or the public sector readily passed these increases in wages on to consumers.

In considering reforms in labour and product markets, it would be important to look at the institutional environment and incentives in product and labour markets. Policy measures may be required, aimed at changing incentives in product and labour markets so as to align the different institutions with a country's development priori-

Figure 1. Gini ratio in relation to collective bargaining coverage

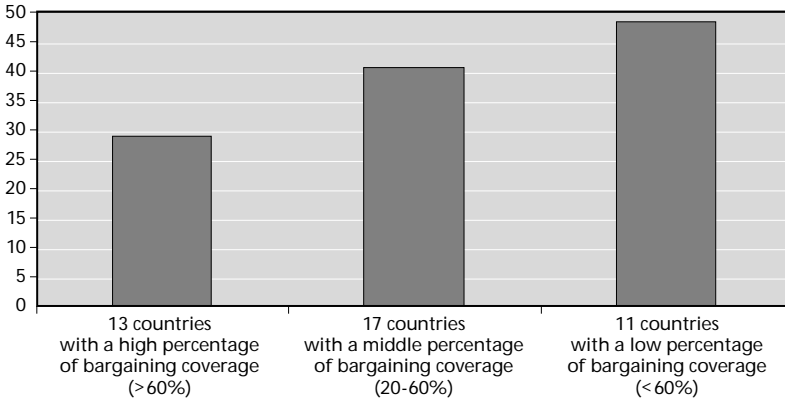


Figure 2. Gini ratio in relation to bargaining coordination

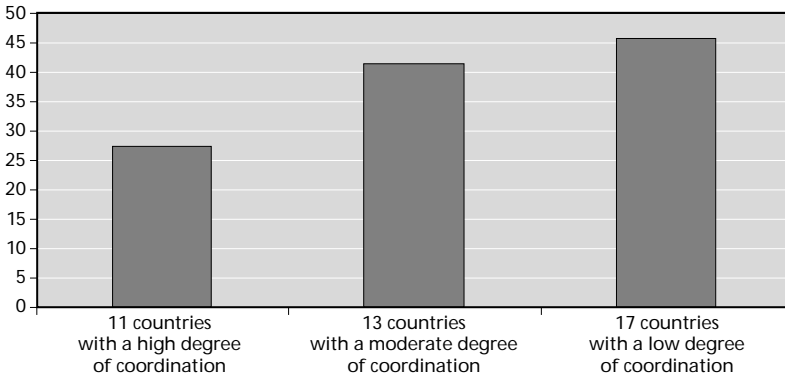
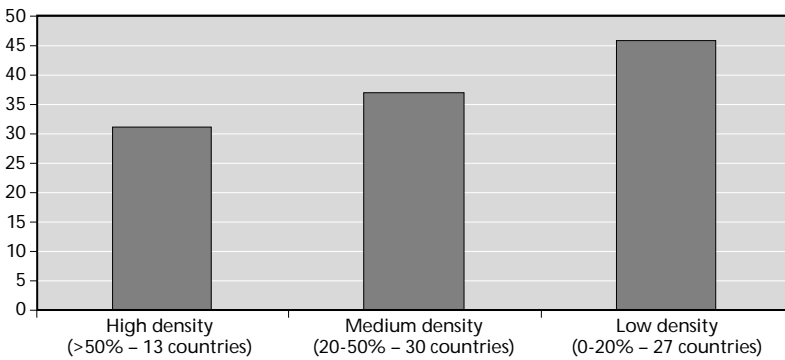


Figure 3. Gini ratio in relation to trade union density



Note: The Gini ratio (or index of income concentration) is a statistical measure of income equality ranging from 0 to 100. A measure of 100 indicates perfect inequality; i.e. one person has all the income and the rest have none. A measure of 0 indicates perfect equality; i.e. all people having equal shares of income. The lower the Gini ratio the higher the equality in income.

ties, and to facilitate smoother adjustment and more equitable development.⁹

Encouraging greater competition in product markets and removing anti-competitive product market regulation can diminish the ability of some unions (and enterprises) to pass wage increases on to consumers. Rather, it may encourage a cooperative stance and productivity-enhancing strategies for increasing pay.¹⁰ This highlights the central role that incentives play in determining the potential effects of trade unions.¹¹

The implied policy response is therefore to promote pro-equity developments in the institutional environment in which trade unions and employers operate rather than to take the fatalistic view that trade unionism is automatically harmful for equity.

Changing the incentives by reforming public-sector employment and liberalizing product markets would provide a more effective route to improving labour market performance than seeking to weaken these institutions:

Labour market reforms should be approached with great humility. [...] restructuring the public sector and changing incentives faced by union [in this case to extract rents] may yield higher payoffs than changing the labour code. (Rama, 1995)

In some developing countries where strong labour institutions have spearheaded political change, the approach to date has been to see strong trade unions as obstacles to development. This has led to attempts to erode and weaken these institutions. The result has all too often been delayed and difficult adjustment processes, as social instability and conflict between various interests begin to escalate.

To ensure that economic reform has the greatest potential for success, it is important to ensure greater degrees of economic democracy by involving trade unions and others in the design of policy reforms.¹² This is an important part of the process of making economic change and adjustment more acceptable. Tripartite and so-

cial dialogue can play an important role in building trust and consensus around reform. This will ultimately lead to policy choices that promote equity and ensure socially sustainable integration. Institutions of social dialogue and of dispute resolution are important complements to policies that promote greater openness.

In the reform and design of policy, deregulation, which has been the leitmotif of the last two decades, is not the answer. Rather, it is important to ensure greater degrees of economic democracy by involving trade unions and others in the design of policy reforms and promoting pro-equity and pro-efficiency incentives in the institutional environment (of product and labour markets).

In other countries where organizations of labour and employers are absent, the challenge is one of providing an environment that fosters the development of these institutions, together with complementary institutions such as those that provide dispute resolution services (mediation and arbitration) and sources that can provide labour market and price information. As labour institutions underpin the way in which labour participates in production and the distribution of the returns, their absence leads to growing social exclusion, from production and from the (formal) economy. Strong organizations of workers and employers are a precondition for effective collective bargaining institutions, and promote social inclusion and cohesion.

Conclusion

Preliminary findings reveal that there appears to be a favourable conjuncture in many countries between the presence of collective bargaining institutions, more equal distribution and smoother adjustment as countries integrate into the global economy. Efforts to undertake liberalization and adjustment by focusing on allocative efficiency in markets and deregulating and weakening collective bargaining institutions may not have been the

best strategy. In certain countries, this has no doubt undermined the role that these labour institutions are able to play in facilitating more equitable development and more successful integration.

The assumption that labour institutions automatically impede economic development and cause rigidities and barriers to adjustment is flawed. Labour institutions appear to play an important role in facilitating more equitable and socially sustainable integration. The outcome depends on the broader configuration of institutions and incentives in product and labour markets. Decision-makers need to take these factors into account when designing policy.

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Annex 1: Samples of countries used

	Figures 1 and 2 Collective bargaining and inequality	Figure 3 Trade union density and inequality
Australia	×	×
Austria	×	×
Azerbaijan		×
Belarus	×	×
Belgium	×	×
Bolivia	×	×
Brazil		×
Bulgaria		×
Canada	×	×
Chile	×	×
China	×	×
Colombia		×
Costa Rica		×
Czech Republic	×	×
Denmark	×	×
Dominican Rep.		×
Ecuador		×
Egypt		×
El Salvador	×	×
Estonia		×
Finland	×	×
France	×	×
Germany	×	×
Ghana	×	×
Greece	×	×
Guyana	×	×
Honduras	×	×
Hungary	×	×
India	×	×
Indonesia		×
Ireland	×	×
Israel		×
Italy		×
Japan	×	×
Kenya	×	×
Korea, Rep. of		×

	Figures 1 and 2 Collective bargaining and inequality	Figure 3 Trade union density and inequality
Luxembourg		×
Malaysia	×	×
Mexico		×
Morocco		×
Netherlands	×	×
New Zealand	×	×
Nicaragua	×	×
Nigeria	×	×
Norway	×	×
Pakistan		×
Panama	×	×
Paraguay		×
Peru		×
Philippines	×	×
Poland		×
Portugal		×
Romania		×
Russian Fed.		×
Senegal		×
Slovakia		×
South Africa	×	×
Spain	×	×
Swaziland	×	×
Sweden	×	×
Switzerland	×	×
Thailand	×	×
Tunisia		×
Turkey		×
United Kingdom	×	×
United States	×	×
Uruguay	×	×
Venezuela		×
Zimbabwe	×	×
Total sample of countries	41	69

Notes

¹ See Rodgers, G. 1994.

² In considering new insights on labour markets and income inequality in a post-Washington Consensus era, Hoesven, van der, R., 2000 emphasizes at least three functions of labour institutions and labour policy: *improving allocative efficiency* (matching supply and demand in the labour market); *improving dynamic efficiency* (increasing the quality of labour and their participation in the production process); and *improving or maintaining equity and social justice* (a distributional function that also promotes social cohesion). He concludes that by focusing on the allocative aspects, the Washington Consensus overlooked institutional options for dynamic innovation, social cohesion and equity – all important components of growth and redistribution policies.

³ For arguments concerning the role of collective bargaining institutions in promoting greater macro-economic stability and reducing the potential for a trade-off between employment and inflation, see Hayter, S., 2002.

⁴ In the early 1980s, analysts argued that corporatist labour-management relations (centralized system of collective bargaining) produced a better inflation-unemployment trade-off, see Bruno, M. and Sachs, J., 1984, and Metcalf, D., 1987. In the late 1980s, analysts argued that either centralized or decentralized bargaining was superior to industry-level bargaining, see Calmfors, L. and Driffil, J., 1988. There was some

critique of this finding, see Layard, Nickell, and Jackman, 1991; and Soskice, 1990.

⁵ See Flanagan, J., 1999.

⁶ See Flanagan, J. 1999; Freeman, R. 1995; and Aidt, T. and Tzannatos, S., 2002 for a review of the literature.

⁷ In particular the classic works of Hirshman, A., 1970; and Freeman, R. and Medoff, J., 1984.

⁸ See Blinder, A., 1990; Kruse, D., and Blasé, J., 1995; Levine, D., 1995; and Tyson, L. and Levine, D., 1990, who survey 43 empirical studies, and find that the effect of worker participation on productivity is usually positive but almost never negative.

⁹ See ILO, 2000.

¹⁰ See, for example, Layard, R. and Nickell, S., 1998.

¹¹ The field of institutional economics is instructive here. It highlights the role that incentives play in shaping the behaviour of organizations. If the pay-offs (incentives) are highest from rent-seeking activities, then we can expect organizations to maximize those margins. On the other hand, if the pay-offs are from productivity-enhancing activities, then we can expect economic growth. The broader institutional environment (including laws, property rights, etc.) together with other economic constraints affect economic outcomes by affecting incentives. See, for example, North, D., 1997.

¹² See Stiglitz, J., 2000; Rodrik, D. 1999; and Forteza, A., and Rama, M., 2001.