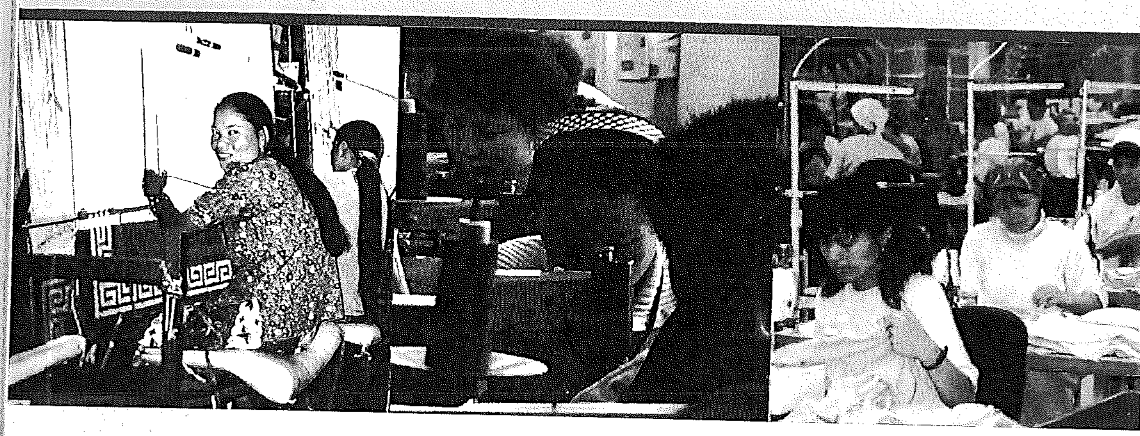
THE PHASE-OUT OF THE MULTI-FIBER ARRANGEMENT:

Policy Options and Opportunities for Asia



The Asia Foundation

Labor Laws in Asia

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Introduction

Workers in the formal sector today benefit from a broad range of legal protections. Government protections in the labor market include regulations that mandate minimum physical safety standards for workers and adequate workplace conditions, set standards for minimum levels of pay and maximum working hours, and require or encourage equal pay and equal opportunities in the workplace. These types of rules are widespread in some form across Asia, and are included among the conventions of the International Labour Organization. Although enforcement remains uneven across the region, there is little doubt that the establishment of minimum standards for workers has benefited at least those workers with jobs in the formal sector.

Of course, these policies may have unintended consequences. Some social policies designed to protect workers may raise the cost to firms of hiring workers who are covered by the standards. While the local community presumably has judged the trade-off between profitability and working conditions as acceptable, the impact of higher worker standards on investment and employment may also represent a transfer from the unemployed (who are forced to forgo new job opportunities) to those with jobs already (and who benefit from the higher standards). This cost to the unemployed poor is rarely given adequate attention.

A full consideration of the potential tradeoffs between social objectives and economic competitiveness takes on added urgency for textile- and garment-exporting countries in Asia, as they seek to adjust to the new global competition following the end of the Multi-Fiber Arrangement. The elimination of quotas is expected to cause significant changes in world patterns of textile and garment production and trade, with large expected gains for China and India and potential losses for smaller exporting countries. This chapter explores the complexity of issues surrounding labor markets and labor policies in Asia.

Countries with textile and garment firms that are vulnerable in the absence of quota-guaranteed access face a set of external conditions that cannot be controlled from within, including world trade rules and low production costs in China. Yet these countries also have a wide range of domestic options that might be used in the short run to enhance their own economic environment. While the main focus should probably remain on trade policies and the state of domestic economic infrastructure, these countries (and especially those with labor-intensive apparel industries) should take the opportunity to re-examine the current state of labor policies and the prevailing patterns of compliance and enforcement.

Conceptual Framework: External and Internal Conditions

Labor costs are only one factor, even if an important one, contributing to how buyers will determine which destination countries will choose their goods, and which sites multinational corporations will choose for foreign investment. As shown in Figure 3.1, labor standards and protective measures for workers entail a number of positive impacts, and also some potential tradeoffs. Laws that allow workers to freely associate and bargain collectively promote social and political stability, which, in turn, enhance both economic growth and incentives for Foreign Direct Investment (FDI). Other important standards that eliminate discrimination and child labor in the work place contribute to greater investment in a country's human capital, also an important determinant of economic growth and the competitiveness of the economic environment. The increase in economic growth also has positive feedback effects for FDI and exports. Furthermore, surveys of corporate managers and firm owners indicate that compliance with labor standards is actually an important reason to source from certain countries or choose them as an FDI destination (Kucera 2002, USITC 2004). Social stability, labor quality, and the regulatory environment are all ranked more highly than labor costs as criteria for attracting FDI. Because labor costs represent only a fraction of total costs in most industries (including labor-intensive industries, such as the garment industry), international buyers may be in the position to prefer locations with peaceful, predictable, and reasonable labor conditions, even if the wage bill is *slightly* higher.

Yet the negative impacts of some policy decisions cannot be ignored. In particular, if firms bear the costs of mandated benefits and higher wages relative to productivity, labor costs will obviously rise.[28] A resulting tradeoff between employers and workers may be the substitution of capital for labor; as wages increase, even at the margin, they affect the firm's decisions of how much capital (or machinery) to use in place of labor. Another possible outcome is the substitution of full-time workers covered by the legislation with causal, part-time, or home-based workers who would remain outside the expanded protections. Higher labor costs could also dampen the competitiveness of the economic environment, potentially causing lower FDI, exports, and jobs. Adjustments to policies that raise labor costs relative to productivity could themselves contribute to the process that is often described as a "race to the bottom."

Labor Law Impacts

As an organizing schema, major labor laws can be categorized into four groups: basic rights, civic rights, job security, and terms of employment. The remainder of this section discusses the objective of important policies in each major group and the impacts that may be generated by implementing these policies. These impacts include changes in labor costs that affect tradeoffs between businesses and workers, as well as tradeoffs between employed workers and job seekers. The existing empirical evidence of policy effects and current policy incidences are discussed, as well.

A. Basic Rights. Widely regarded as core labor standards, the abolition of child labor, forced labor, and labor-market discrimination has obvious objectives. Although there is widespread disagreement about the best way to enforce legislation regulating basic rights, a consensus has emerged that these rights cannot be compromised. The abolition of child labor is expected to have a positive impact on the competitiveness of the economic environment, mainly through the channel of human capital investment. School enrollment rates are a key determinant of economic growth, and economic growth, in turn, is positively associated with more FDI and greater exports. Another direct link to FDI, apart from growth, is the tendency for multinationals to invest in or source from countries abiding by this fundamental labor standard. All Asian economies have labor regulations on governing the use of child and forced labor. Although there is some variation across countries in restrictiveness and coverage, most of the variation comes in the enforcement of the regulation.

The tradeoffs involved with legislation targeting no discrimination are considerably more complex with regard to predicted impact on the labor market. In an effort to eliminate discrimination in employment and pay against women, most countries have adopted policies that promote equal treatment in the workplace. The two most common types of such policies are equal-pay and equal-opportunity measures. These measures do not target women for protection or special treatment, but do have the explicit goal of improving women's labor market outcomes. The "equal pay for equal work" clause requires employers to provide equal pay for workers performing the same job with equal efficiency, regardless of gender. The legislation is often applied to narrow job titles within establishments. In a perfectly competitive labor market, equal-pay legislation should raise women's wages if women work in jobs that contain within-job pay inequities. The pay increase for women may come at the cost of employment losses for women if employers justify previous wage discrepancies on perceived differences in productivity, or if overall cost structures generate a decline in total employment levels.

In practice, equal-pay legislation tends to have more success in industrialized countries where collective bargaining is common and differential pay rates by gender are relatively easy to change (Tzannatos 1999). Within Asia, most nations have an equal-pay clause, but fewer than half of these countries go the next step by prohibiting sex-based employment discrimination. Published evidence on the impact of this type of legislation in Asia is limited but seems to point in the direction of little to no impact due to the lack of enforcement. For example, Behrman and Zhang (1995) point to the lackluster performance of equal opportunity legislation in Asian developing economies. In many countries in the region, women continue to face a considerable glass ceiling in administrative and supervisory positions, despite strong gains in their education (e.g., Zveglich, Rodgers, and Rodgers 1997, and Rodgers 1998).

B. Civic Rights. Civic rights include the freedom of association, the right to collective bargaining, the right to organize, and the right to express grievances freely. The enforcement of these rights would be expected to cause higher wages in the formal sector, as union activities are often directed at least partly at raising wage levels. However, the impact on the demand for labor in the formal sector is ambiguous, with ambiguities occurring through both macroeconomic and microeconomic channels. On the macroeconomic side, stronger civil liberties and political rights are sometimes considered conducive to economic growth and economic stability (Stiglitz 2002, Rodrik 1999). A context in which civic rights are better protected might be expected to have less conflict and more stability, both of which are favorable for attracting new investment. Increased investment, in turn, encourages economic growth and the creation of new jobs in the formal sector. In contrast, Singh and Zammit (2000) argue that if civic rights are granted quickly (such as when a country ends martial law), the likely result is a reallocation of workers away from the formal sector to the informal sector. From this perspective, granting new freedoms may lead to strikes and economic disruption that push workers into the informal sector and worsen the average conditions faced by the local workforce.

On the microeconomic side, the protection of civic rights, in itself, does not necessarily result in a shift of labor away from the formal sector to the informal sector (Galli and Kucera 2004). For example, collective bargaining itself is rarely seen as a disincentive to invest, but policies that introduce rigidity into the labor market (e.g., policies that make it more difficult to terminate unneeded or unproductive workers) can represent important disincentives to investment, and rather than the protection of civil rights, these poor business conditions are much more often the real culprits behind an employment shift from the formal sector to the informal sector. Moreover, stronger bargaining positions for workers (e.g., via collective bargaining arrangements) are likely to raise wages in the formal sector, and higher wages would be expected to cause the demand for workers in the formal sector to shrink. Given these conflicting forces through both the macro- and the microeconomic channels, the impact on employment and the overall economic environment becomes an empirical issue that can only be determined on a case-by-case basis.

C. Job Security. The most important regulations in the area of job security include provisions guaranteeing no arbitrary dismissal and the right to retirement compensation. Stronger job security rights are expected to reduce job turnover rates, particularly for workers in the formal sector who have the least tenure. In addition, stronger job security rights are linked to lower variability of formal sector employment over the course of the business cycle. In particular, strict job security regulations make it more difficult for firms to let go of workers during economic slowdowns. Further, the potential of high dismissal costs in the future will discourage firms from taking on new workers during economic recoveries (Bertola 1990).

The impact of job security tights on formal and informal sector employment has more ambiguities. The common argument is that these regulations limit wotket flexibility and raise worker costs, thus pushing workers from formal sector employment to the uncovered informal sector. Similarly, one would expect to see countries with weaker job security regulations have less employment in the informal sector (given the lower incentives for business to utilize workers in the informal sector). However, Galli and Kucera (2004) argue that there are short- and long-term effects. In particular, if a country were to weaken its job security rights, the immediate impact would be more worker dismissals than working hires in the formal sector, resulting in an inctease in the share of workers in the informal sector. They found, however, that in the longer term, as firms face relatively low costs associated with worker dismissal, the equilibrium outcome might be a net gain in formal sector employment, as firms restructure the composition of their workforce.

D. Terms of Employment. There are numerous policies covering the terms of employment. This analysis focuses on two policies that can involve sizeable distortions when the regulations are relatively excessive: the minimum wage and working hour resttictions for female wotkets.

Although minimum wage laws are primarily used to lift the income of poor workers, the policy may entail distortionary costs that adversely affect the poor. In a perfectly competitive labor market, an inctease in a binding minimum wage causes an unambiguous decline in the demand for labor. Jobs become relatively scarce, and some wotkets who would ordinarily work at a lower market wage are displaced, even while others see an increase in their wages. Advocates argue that employment losses are small, and any reallocation of resources that occurs will result in a welfare-improving outcome through the reduction of poverty and improvement in productivity. Critics, however, claim that employment losses from a minimum wage-induced increase in production costs are substantial.[29]

Distortionary costs from minimum wages are more severe in developing countries with their large informal sectors (World Bank 1995). In particular, the minimum wage primarily protects workers in the urban formal sector, whose earnings already exceed by a wide margin the earnings of workers in the rural and informal sectors. Employment losses in the regulated formal sector translate into more workers seeking employment in the unregulated informal sector. The end result of a binding minimum wage law in developing countries could actually decrease, not increase, average wages for poor workers. Even a small increase in the minimum wage can have sizeable disemployment effects in developing countries if the legal wage floor is high relative to prevailing wage rates, a large proportion of workers earn the minimum, or the minimum wage provisions are enforced.

Noncompliance with minimum wage regulations, however, is widespread in developing countries, and is directly related to the difficulty of enforcement for countries with low public administration capacity (Squire and Suthiwart-Narueput 1997). Because minimum wages are more difficult and costly for the government to enforce fot small firms in the informal sector, noncompliance is more common in this group. Compliance costs are higher for smaller firms in the informal sector because there are so many firms with small workforces. Enforcing the minimum wage provisions would also be more costly fot these small informal firms relative to larger firms, as they tend to hire more young, unskilled, female workers than larger firms in the formal sector. Given that average wages for these demographic groups are lower, the minimum wage would more often be binding and have a larger impact on the average wage bill.

Noncompliance can take the form of outright evasion, exploitation of legal exemptions for part-time and temporary workers, and cost-shifting through the avoidance of overtime premiums. Employers may also erode the anticipated benefits of the minimum wage provisions by opting to comply with the minimum wage but reducing the non-wage benefits that remain uncovered by minimum wage legislation, such as paid sick days, holidays, health insurance, and retirement benefits.

Cross-country evidence shows that labor force participation rates drop more for women than men when the minimum wage rises relative to income per adult (Schultz 1990). In Indonesia, in 1994,the minimum wage amounted to roughly

60 percent of average wages for all workers, a figure that is already high relative to most developing countries, and over 80 percent of average wages for women (World Bank 1996). Higher wage costs from Indonesia's minimum wage place particularly tight constraints on those manufacturing industries, such as textiles, clothing, and shoes, which are labor-intensive and trade in competitive world markets. Because women workers comprise a substantial share of the workforce in these industries, they experience the brunt of employment cutbacks that firms may make to re-establish their international competitiveness.

Women and men are also affected differently by the noncompliance of employers. Greater noncompliance for female workers has been documented in a number of countries, including Indonesia.[30]

The most common types of working-hour restrictions are limits on overtime and prohibition of work at night. Overtime stipulations require firms to compensate workers with a wage premium for hours worked beyond the legal workday. Many governments constrain the total number of hours, including overtime that workers may work within a day. Night-work prohibitions constrain the time of day when workers can be employed. These restrictions, traditionally more severe for female workers, were once justified by the need to reduce the danger that women face when they travel to and from work late at night, and the need to have working women spend more time at home. When coverage differs by gender, these restrictions cause firms to have less flexibility in their hiring of female workers. Firms could substitute away from female workers altogether toward male workers or capital, causing a reduction in the total hours worked by women. The extent of these changes depends on a variety of factors, including the substitutability between male and female workers, the substitutability of capital for different types of labor, and the extent of overall production cutbacks due to negative scale effects.[31] On the supply side, if the regulations are binding, women will most likely supply fewer working hours for a given wage. A night-work prohibition reduces women's flexibility in determining the time of day when they work and, when binding, leads to fewer working hours. Overtime limits lower the cap on the number of hours that a worker may supply and, when binding, also lead to fewer working hours. In a study of Taiwan's enforcement of its 1984 labor standards legislation, evidence supports these theoretical predictions (Zveglich and Rodgers 2003).

Working-hour restrictions are widespread in Asia. Table 3.1 illustrates the range of policies across countries. Night-work prohibition is the most common restriction, although the severity of the legislation varies considerably across countries. For example, Thailand deviates considerably from the International Labour Organization (ILO) standard by starting the restricted hours at midnight and specifying only six consecutive hours of rest. At the other extreme, Indonesia requires women to end work by 6:00 p.m. and not resume work before 6:00 a.m. Many governments allow exceptions for certain occupations and activities, and coverage varies by industry and firm size. Restrictions are typically greater for pregnant women and women with newborn children. Special overtime limits for female workers are less common. Most Asian countries have adopted overtime limits for their workers; fewer than half of these countries have overtime limits that differ across sex. Some countries, such as India and Bangladesh, ban overtime work entirely for women but not for men.

Conclusions

This chapter has argued that as Asian textile and garment producers seek to enhance their economic environments, they emphasize making labor standards more enforceable, unambiguous, and fair to both businesses and workers. There is a strong economic rationale for increasing compliance with labor-market regulations that improves human capital, are consistent with fundamental worker rights, and results in labor costs that are in line with market benchmarks. Results from tests of the competitive labor market model generally support the conclusion that regulations consistent with the International Labour Organization's core labor standards have a positive impact on formal sector employment, the quality of human capital, and political stability. These positive impacts, in turn, enhance a country's economic environment and encourage FDI and exports. Hence, for sustained industrialization to occur, countries take the "high productivity" rather than the "low wage" route to growth. When labor market regulations are set too far out of line with prevailing market benchmarks, however, the benefits gained by workers in the formal sector must be considered in the context of lower overall employment levels, a shift of jobs to the informal sector, and the economic and social costs associated with government compliance efforts, private sector avoidance efforts, and the opportunities for collusion and corruption that may be generated.

Other regulations designed to structure the terms of employment, although potentially costly to implement, have strong positive impacts on human capital and are also conducive to the "high productivity" route to growth. Measures such as safe workplace conditions, overtime pay, and paid benefits promote lower turnover rates, improve well-being for workers, and extend firm-specific tenure. Although protective legislation is widespread among Asian economies, available evidence indicates that a significant number of all workers are either not covered by the legislation, unaware they are entitled to benefits, or employed in covered firms that fail to comply with the legislation. As a policy priority, protective legislation that raises the productivity of workers and investment in their human capital needs to be provided to a broader range of workers by removing exemptions, promoting awareness of benefit availability, and increasing enforcement. Institutional reforms may be necessary to provide the incentive for agents to respond to legal changes that otherwise lack credibility.

Measures to back mandated benefits with public funds, such as social insurance, can go a long way to ensuring greater compliance among firms. Mandates on firms without compensation from public funds tend to result in greater inequity, with beneficiaries' wages falling to offset the cost imposed on firms. These drawbacks have motivated some advocates of mandated benefits to call for the public provision of benefits, ideally through a system of national insurance. However, publicly financed benefits yield greater inefficiencies arising from the deadweight loss of general taxation (Summers 1989). The debate between employer mandates versus public provision then becomes one of efficiency versus equity.

Some standards, while perhaps achieving social objectives, will reduce workers' welfare by limiting the choice set of alternative compensation packages. At the same time, labor costs may rise relative to worker productivity or to market standards. For example, working-hour restrictions for female workers ought to be removed once the measures can no longer be justified by the need to prevent dangerous and exploitative working conditions. Protective measures that constrain women more than men in their working-hours can hinder women's progress towards equity in the labor market. The measures contribute to the exacerbation of occupational segregation by sex, as some employers become resistant to hiring women who have less flexible working-hour options. Other examples include

minimum wages that are set far in excess of market-clearing wages, as well as restrictions that make it exceedingly difficult or expensive for firms to let go of workers in times of structural change.