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Low labour standards as a global competitive advantage of the South?

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In industrialised countries, globalisation is commonly perceived as being associated with a decline in working conditions. It is claimed that the process of globalisation and increased international trade with developing and emerging nations has forced industrialised countries to reduce their labour standards. The alleged result is a downwards spiral, with competition encouraging a race to achieve the lowest working standards.

It is true that there are considerable differences in occupational health and safety regulation around the world, which is one example of labour standards? In industrialised nations, legal regulation of safety standards at work is more or less taken for granted. For example, employees are protected from excessive exposure to chemicals. There are radiation limits for medical staff exposed to above-average levels of radiation and for computer users. There is a whole raft of rules for the construction industry, from the requirement to wear hard hats through to the use of safety harnesses to prevent falls. In general, industrialised countries have a lot of rules that are designed to protect workers in the workplace.

But what is the situation in developing and emerging countries? If we make the reasonable assumption that there is a correlation between safety standards and accidents, then there is a marked difference. In OECD countries, the number of fatalities at work is 4 per 100,000 workers per annum. In contrast, the figure is 10 for India and China, and over 20 in other Asian and African countries (Hämäläinen, Takala and Saarela, 2006). Figure 1 plots workplace accident rates against GDP per capita. The chart reveals a strong negative correlation: richer countries tend to have fewer workplace accidents.

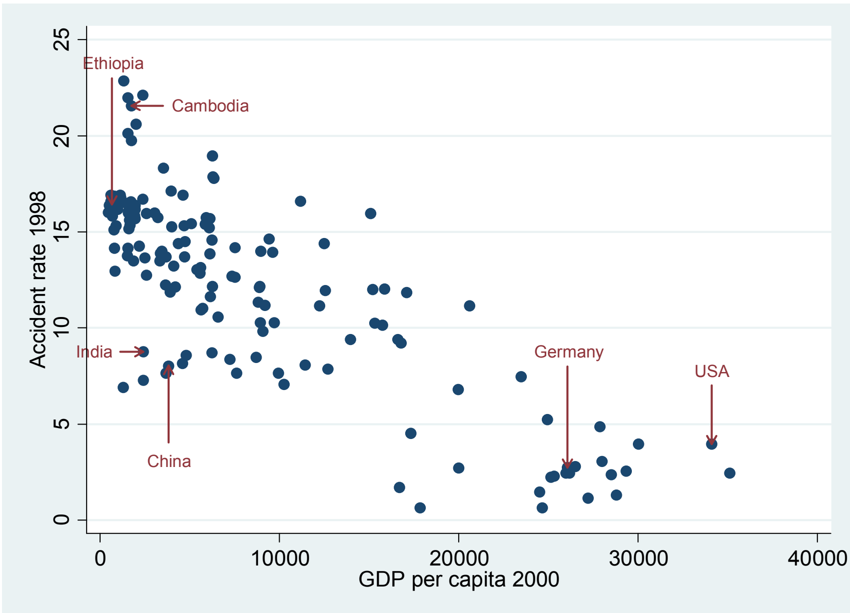
The main questions and processes

We need to address a few key questions in this regard. If countries are competing for international investment, do these differences constitute an unfair competitive advantage? Are countries like Germany, which have relatively high labour standards compared with other countries, at a competitive disadvantage? Should we be worried that capital and investment is likely to migrate to developing and emerging countries because Germany has "too many" requirements, making for an "overly expensive" health and safety system? Will globalisation therefore prompt a deterioration in working conditions in industrialised nations? Do poor labour standards ultimately give developing and emerging countries a competitive advantage on the world market?

Despite widespread public interest in globalisation and working conditions, there is surprisingly little scientific research into how trade and foreign direct investment affect labour standards. To date, all studies have analysed specific cases or been limited to general observations.

We have developed a mathematical model that can be used to calculate the conditions under which foreign direct investment outflows will trigger lower labour standards in the northern hemisphere. Using the modelling tool, we can estimate the extent to which

Figure 1: Negative correlation between accident rates and GDP per capita



Source: own research; data on accident rates from Hämäläinen, Takala, and Saarela (2006); GDP per capita figures from World Bank World Development Indicators {http://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD} globalisation has affected occupational safety in northern countries. Has international competition increased accident rates in Germany by 0.1% or 10%? In order to answer this question, we first need to establish whether differences in national occupational safety rules cause investors to abandon countries with high standards. We want to know whether developing and emerging countries with lower working conditions attract higher volumes of foreign direct investment. Once we have the answers to these questions, we can consider the potential impact of higher standards in developing countries.

Institutions and unions – the cornerstone of better working conditions

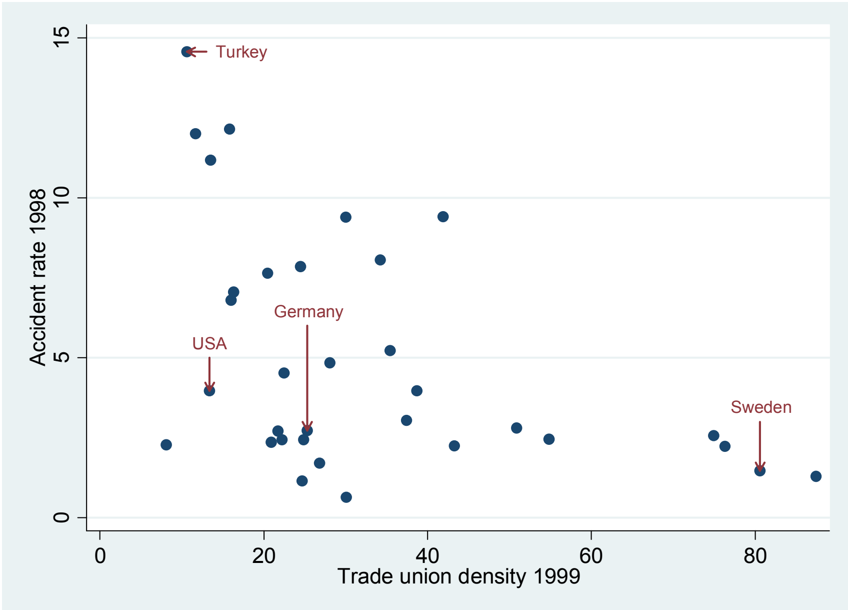
The economic policy implications become more apparent when we consider that safety standards in mature industrialised countries are set by institutions. In the past, conditions were mainly defined by trade unions, but nowadays it is the role of public bodies like the German Federal Institute for Occupational Safety and Health. There is still a great deal of work to be done in most developing and emerging countries in this regard.

The truth is that, even in developed countries, high safety standards only became the norm relatively recently. Rules on working conditions are the result of a long and complex process (Judkins, 1986). The process usually begins with activities organised by groups of workers and ends with the creation of a government body responsible for safety. For some standards, the process can take many decades. Often the starting point is collecting information about hazards in the workplace, followed by scientific evidence of a link between work and health risks for workers, then lobbying activities, drafting a legal framework, and eventually the creation of a government body to enforce the standards. Figure 2 shows that the number of accidents at work decreases as unionisation increases.

Unions play a pivotal role in all phases of the process (Donado and Wälde, 2012b). Unions have the advantage of being able to gather far more information (through their members) than any single worker could. Consequently, unions are able to rapidly fill in the gaps in incomplete data on the health implications of various activities.

Take silicosis as an example of how long and complicated the process can be: silicosis is a common hazard for miners and other workers. A Scottish doctor first identified a possible causal link between work and illness in 1831. It was not until more than 130 years later, in the wake of many more patients, protests, strikes, investigations, expert opinions and conflicting expert opinions that the US Government passed the Coal Mine Health and Safety Act, which officially recognised the link. Similar stories can be found in agriculture, the pottery industry and the automotive sector. The issue is still relevant, as demonstrated by the current debate surrounding burnout syndrome and associated stress-related disorders as occupational illnesses.

Figure 2: Negative correlation between accidents at work and unionisation



Source: own research; data on accident rates from Hämäläinen, Takala, and Saarela (2006); OECD unionisation figures {http://stats.oecd.org/Index.aspx?QueryId=20167}

This example also proves that establishing functional trade unions in developing and emerging countries – and then internationally-recognised labour standards – will be a slow and gradual process. Setting aside the clear human rights benefits of the process, is it worth pursuing on economic grounds?

Better occupational safety increases profit and therefore prosperity around the world

The first fundamental finding of our research has been that investment does not migrate to countries with the lowest labour standards. Health and safety at work is primarily a cost factor for individual businesses. However, it benefits society as a whole. Not only do fewer workers fall ill – in itself a good thing – there are also productivity and location benefits for the national economy as a whole. Consequently the return on investment increases in proportion to the actual labour supply in a country. If a country has high levels of downtime caused by sickness and low life expectancy, average worker qualifications will be lower, ultimately reducing the potential returns for investors. Alsan, Bloom and Canning (2006) have produced empirical data to support this theory: foreign direct investment increases in proportion to average national health.

This correlation also explains another finding: high standards in industrialised countries tend to result in lower volumes of capital outflows abroad compared with countries that lack such standards. Occupational health regulation reduces absences, thereby decreasing disruption to production processes.

Of course, there is no denying that in purely financial terms, there is an optimum level of health and safety protection. Healthier workers mean increased productivity, which is desirable, but also entail higher costs for companies. As a result, excessive regulation of working conditions will eventually generate disadvantages. However, it would appear that industrialised nations have a long way to go before they reach that point. Alsan, Bloom and Canning (2006) found that developing countries can actually benefit from greater occupational safety.

No significant downside for industrialised nations, but considerable benefits for developing and emerging countries

Although occupational safety can improve the return on investment by boosting workforce productivity, some capital – particularly foreign direct investment – has moved to target developing and emerging markets. However, the general public seems to have overestimated the negative impact of capital outflows on prosperity levels.

Firstly, this is due to the fact that total capital flows (foreign direct investment plus portfolio investments) are actually negative in some cases, i.e. inflows from developing countries to industrialised nations exceed outflows. This gave rise to the Lucas paradox: "why doesn't capital flow from rich to poor countries?" (Lucas, 1990). A lot of empirical data has proven this paradigm, such as the work done by Prasad, Rajan and Subramanian (2006). At the same time, foreign direct investment in developing countries is a source of income for investors in industrialised countries. Consequently the net result should be that prosperity in industrialised countries will be boosted by foreign direct investments. Occupational safety may decline slightly, but to a negligible degree.

But what would happen if working conditions were to improve in developing and emerging countries? Would that not put industrialised nations at a disadvantage?

The answer depends on the volume of capital flows from industrialised to developing countries. We can use an extreme scenario by way of illustration.

Let us assume that 20% of capital from an industrialised country migrates to a developing nation. Pay levels would fall in the industrialised country, which in turn would reduce willingness to absorb the cost of maintaining high standards. The transfer of a massive 20% of capital would trigger an increase in sickness rates from 2% to just 2.15%. Therefore there would be no noticeable difference in sickness rates in the northern hemisphere with a more realistic level of capital migration.

The welfare gains for industrialised countries generated by capital outflows to developing and emerging countries more than offset the potentially low negative impact, so on balance global welfare would actually increase.

Labour standards are good news for industrialised and developing countries alike

Occupational health and safety is both economically and socially desirable. In this era of globalisation, there is no reason to reduce these labour standards. Opponents of globalisation are right that in theory increased international competition could give rise to a reduction in labour standards, but the actual effects would be so limited as to be negligible. Improving labour standards in developing and emerging economies would have minimal negative consequences for industrialised nations, but would have very significant benefits for the developing and emerging countries.■

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