

# Investment, employment and South African labour laws:

An international comparison

**WS Siebert**

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## Foreword

The purpose of FMF *Monographs* is to use the analytic method of political economy to shed light on how best the promotion of free markets will improve the workings of the South African economy. In particular, authors are urged to apply the microeconomic approach of studying how individuals, firms and households behave in response to either naturally occurring or regulatory induced incentives. This requires that they display a sound, institutional knowledge and understanding of their theme. Where macroeconomic aggregates are introduced into the discussion, FMF authors analyse them from the market perspective, namely from the foundation stones of economics itself, supply and demand, the interactions of countless individuals with differing preferences and intentions. This approach also requires that authors pursue their analysis in a logical fashion to policy proposals unencumbered by preoccupations as to what is or is not politically practicable at any given time. They should not be tailored simply to gain the approval of pre-existing (but from a historical perspective transient and ephemeral) vested interests of political groupings (most obviously in this instance, trade unions).

The author of this *Monograph*, Stanley Siebert, writes within this framework. Siebert is a labour economist with a strong training in micro theory and a lengthy professional interest. It would not be easy to find a more relevant topic for beginning-of-millennium South Africa.

In this international study, Professor Siebert notes that South African real wages – in relation to the comparator countries, have increased. So too has union density (union membership as a percentage of employment). He argues that there is a strong linkage between increases in union power, higher real wages and increasing unemployment. Investors after all, shy away from investing in projects where total costs are relatively higher. This cost disadvantage, Siebert argues, has been further enhanced by the adoption by South Africa of European style, job security legislation.

Siebert argues that real wages can be increased and employment expanded if investment rises and demand for labour follows. Alternatively, real wages can rise because of increased union power and employment will fall. The issue is to identify which scenario applies.

Siebert also tackles a third scenario. Increased union power may improve the operating efficiency of the market by its incorporation into a government decision making or advisory body such as NEDLAC. A knowledgeable body will make recommendations on wage determination that more accurately and more readily reflect supply and demand than would decentralised negotiators. The latter are more likely to be unaware and uncertain of each other's true positions. Or so the theory goes.

Siebert refutes this latter explanation on empirical and further theoretical grounds. OECD data, holding other things constant, link unionisation with unemployment. On the other hand, centralised bargaining, other things equal, is linked with lower unemployment. The problem is that the other things are not equal, and centralised bargaining is also linked with labour laws that raise labour costs to business and so unemployment. Centralised bargaining seems to offset the effects of high union density (perhaps government power reinforces the wishes of employers, in bargaining for money wage restraint). But centralisation seems to have negative effects on employment in other ways (perhaps unions can more readily influence legislators to introduce and enforce costly and stringent legislation).

The issue then reverts to assessing which of the original two scenarios apply.

Poland, along with New Zealand, Australia and Ireland have avoided the current South African dilemma. Siebert suggests the reason is due to labour market deregulation in these economies (reducing the effects of union density). In South Africa, by contrast, labour market regulation has moved in the opposite direction. Siebert cites the *Labour Relations Act 1995* and the *Basic Conditions of Employment Act, 1997* as laws increasing the cost of employing labour.

In a careful analysis of the strictness of job security laws embracing factors such as procedural difficulties of dismissal, notice and severance pay required, and dismissal difficulty, Siebert produces an "overall strictness of protection" index, which ranked the comparators. South Africa is not very different from Poland, which in turns lies 12th out of the 27 countries in the OECD study (to-

wards the OECD's less strict end). That is consistent with the views of those who argue that South Africa's legislation is not atypical of that of many rich and emerging economies.

Siebert argues that this is too sanguine an interpretation. For example, Korea and Turkey with high job security scores have weak unions, and therefore probably have less zealous monitoring of law application. Second, most OECD laws have been in place for some time, and in some of those countries unions have had their power restricted. South Africa's laws are new, there is strong union power, and therefore a labour market adjustment is to be expected. Third, job security laws "bite" most when times are uncertain. If it is hard to fire, reluctance to hire is enhanced. And investment in South Africa is currently a very uncertain activity.

Fourth, Siebert questions whether South Africa should have positioned itself (in policy terms) closer to the non-monetary end of the money: non-money income trade-off for its (potential) employable population. In a poorer country (unlike the OECD nations) it is possible that most (potential) employees would prefer relatively higher (if more uncertain) money incomes as opposed to more job security. Job security is presumably a normal good. That is, as workers become better off they will prefer to take part of their incomes in non-money forms. When they are poorer they will prefer money in hand (paying jobs) rather than job security (conditional on having a higher cost, but less readily available job).

And this is not just the outcome of the hypothetical logic with which Siebert began. Investment does seem to flow into countries with lower labour costs in terms of labour market strictness, raising or complementing a rise in the demand for labour (see Graph 3, p.26).

A recent paper by William N Cooke (forthcoming) supports Siebert's views, adding both credibility and urgency to the situation. Cooke drew on economic propositions underlying theories of foreign direct investment and organisational propositions underlying international human resource management strategic decision-making. In deciding where to invest, multinational companies (MNCs) assess both (1) the net comparative labour cost advantages associated with alternative host country labour law systems and (2) the comparative flexibility afforded them by alternative systems to either transfer or create preferred labour management strategies abroad. The results of his study indicated that, on average, MNCs from the major investor countries of the world give substantial weight to differences in national systems in deciding how much to invest across alternative high skill-high wage countries. In particular, the evidence indicated that MNCs invested more in countries with higher skills, lower compensation costs and lesser government and collective bargaining constraints on a firm's flexibility to set the terms and conditions of employment or otherwise deploy preferred managerial practices.

The reduction of unemployment is a major policy goal in South Africa. So too is an increase in the level of foreign investment. There may have to be a choice made between these objectives and that of labour market regulations such as those of Western Europe. Other FMF studies have also discussed this trade-off from differing perspectives (see References below).

Professor Siebert's *Monograph* is a sobering evaluation of the ill effects of labour market interventions. The views he expresses are his own and are not necessarily shared by the members of the Foundation.

However, the FMF offers this *Monograph* as a contribution to the current debate. Few controversies are more important in South Africa today than those over the nature and desirability of "labour market flexibility". Professor Siebert's input to that debate should not be ignored.

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## The author

W Stanley Siebert is Professor of Labour Economics at the University of Birmingham. He was educated at the University of Cape Town and the London School of Economics, where he obtained MSc and PhD degrees. He is co-author, with Solomon W Polachek, of *The Economics of Earnings* (Cambridge: Cambridge University Press, 1993). He has lectured widely in the United States, recently as Visiting Professor at the University of Wisconsin, Milwaukee (from 1997). His research interests include the economics of discrimination, workplace health and safety, and the economics of education. For the London-based Institute of Economic Affairs he has contributed 'The Market Regulation of Industrial Safety' to *Regulators in the Market* (IEA Readings No.35, 1991), and, with John T Addison, *Social Engineering in the European Community: The Social Charter, Maastricht and Beyond* (Current Controversies No.6, 1993). He is the author of numerous articles in academic journals and has researched labour market issues in a wide range of countries.

# 1 Introduction

South Africa's recently passed labour laws are not significantly out of step with the recommendations of the OECD Jobs Study (1994)<sup>1</sup>, except in the area of enhancing the flexibility of wages. In this regard, the Labour Relations Act's promotion of sectoral collective bargaining agreements, which can be extended to non-participants, appears to run counter to the recommendations of the Jobs Study. South Africa's labour legislation is not atypical of that found in many industrialised and emerging market economies.

(IMF, 2000a, 30)

How can policy makers create an environment which minimises the negative effects of trade unions, while encouraging them to contribute to economic growth and equity?

(World Bank statement, in Weeks, 1999, 163)

South Africa in the 1990s has seen increases in real wages, in union power and in unemployment. Are these developments related, and will South Africa's new European-style job security laws help the unemployment problem? The paper attempts to answer this question using a comparative framework. South Africa's labour laws and outcomes are compared with eight other industrialised and emerging economies (chosen by Business South Africa), as shown in the accompanying tables. There have already been two comparative investigations of South Africa's labour laws and outcomes, by the South African Foundation (SAF, 1996), and the IMF (2000a). The approach here is closest to that of the South African Foundation (1996)<sup>2</sup>, but with the advantage of four years more South African data. The IMF study is less detailed, and came to the challenging conclusion given in the quotation above. We will build on both these investigations.

Our eight comparator countries present an instructive diversity in the variables in which we are primarily interested, that is, in wages, unions, unemployment, and job security laws. This diversity is a result of different histories, and different government industrial policies. Knowledge of this background is essential to appreciate labour developments. Therefore, Appendix 1 presents a thumbnail sketch of the labour market background in each country. This information will be drawn on as appropriate.

In South Africa, the main problem is how to increase employment. Employment in turn has many determinants giving rise to the OECD Jobs Study (1994) recommendations as follows:

1. *Make wage and labour costs more responsive to local labour market conditions and skill levels of workers.*

As the South African Foundation (1996, 91) puts it: "The South African labour market functions exceptionally poorly, especially at the low skills end". The wage aspect is important, and we need careful analysis of real wage trends and trade union arrangements in our nine countries.

2. *Reform job-security laws that reduce job expansion, and increase unemployment duration.*

This aspect could be fundamental given the 1995 Labour Relations Act coupled with the 1997 Basic Conditions of Employment Act and the Employment Equity Act. We need a thorough analysis of job security provisions across the nine countries.

3. *Reform tax and welfare benefit systems that both decrease the demand for labour and reduce the incentive to take a job.*

The tax-benefit system is not so disadvantageous in South Africa (although studies show it increases unemployment elsewhere<sup>3</sup>), so the comparison here need only be brief.

4. *Improve labour market skills through improved training and education systems.*



However, as the South African Foundation (1996, 105) notes, too much should not be expected of training since “it is difficult to train someone without a particular job in mind”. General education programmes are less controversial. The high education levels of, for example, Korea must help growth. South Africa is at the other end of the spectrum. At the same time, education programmes are a long-term issue and cannot bear fruit if the employment and investment are not forthcoming. Nevertheless, a brief comparison of this important factor is required.

The plan of the paper is to discuss areas 1 through 4 above in turn. In the next section we will take up real wages, unemployment and trade union issues. Then in the third and fourth sections we will consider job security laws and, briefly, the comparative position with regard to tax-benefit and education systems. Conclusions and policy implications are presented and summarised at the end.

1. The OECD Jobs Study (1994) was the outcome of a major research effort by the OECD to analyse and provide recommendations to reduce the rising unemployment affecting most OECD member states since the 1970s.
2. The South African Foundation (1996) study considered 15 countries. This group did not include Brazil, Korea and Malaysia.
3. For example, the IMF (1999a, 17) reports 13 per cent of New Zealand’s working age population receive welfare benefits as their major income source. Generous welfare benefits lead to high unemployment, as modern statistical studies show (see, eg, Nickell and Layard, 1999, 3053).

## 2 Real wages, unemployment and trade unions

### A logical framework

To analyse employment and unemployment it is easiest to start with a basic supply and demand diagram. Such a diagram will tell us what to look for in the subsequent comparative inquiry. Figure 1 gives the diagram we will use. Initial equilibrium is shown as point A. Unemployment ( $U$ ) is given by the difference between employment and the potential labour force, as shown.

**Figure 1: Simple supply and demand**

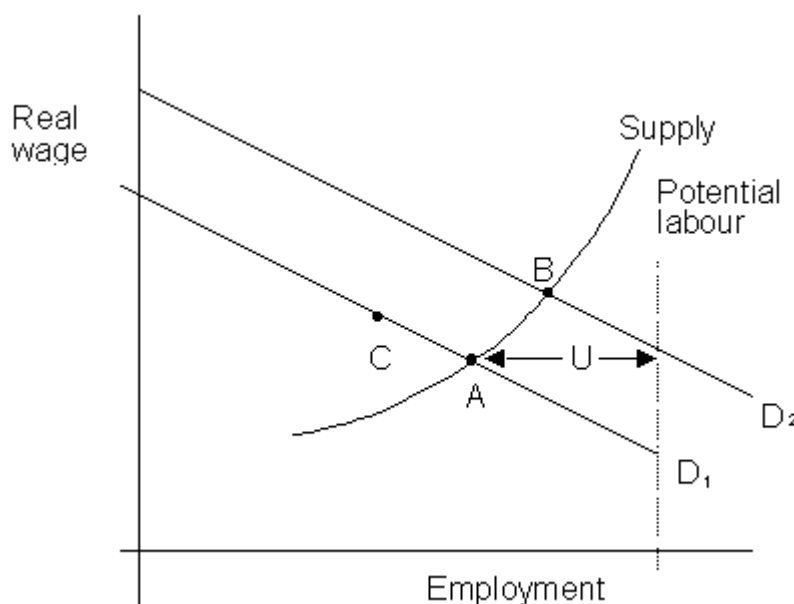


Figure 1 can be used to illustrate two possibilities, one good, and one bad. Let us take the good possibility first. Here, the economy expands, for example due to investment inflows, and the labour demand curve moves outwards from  $D_1$  to  $D_2$ . At any given real wage, more people can be employed. The economic expansion will bring about a new equilibrium such as B, with higher real wages and employment, and lower unemployment. Secondly, there is the bad possibility. Here, trade union power forces wages upwards, with demand and supply unchanged. The result is a new equilibrium such as C, with higher real wages, but lower employment – and correspondingly higher unemployment. The question is whether the good or the bad scenario is ruling in South Africa.

It might be objected that Figure 1 is over-simple. Trade union power – so long as it is exercised responsibly by being “incorporated” into government decision-making – might improve the functioning of the economy. This argument in favour of corporatism dates back to Calmfors and Driffel (1988). The argument has recently been amplified in relation to the Dutch corporatist experience in an influential book by Teulings and Hartog (1998). According to Teulings and Hartog, both firm and worker make specific investments in the employment relationship. Neither side know the value of the other’s investment. In these circumstances, the parties fear “hold up” and do not trust each other enough to permit wages to be changed even when there is a demand shock. In a decentralised set-up, therefore, the parties require wages to be inflexible. On the other hand, wages set by knowledgeable outsiders – by an industry bargaining council, for example – can more easily be revised to reflect demand shocks. The flexibility argument is thus turned on its head. Corporatist economies are more, not less flexible than decentralised ones (for a fuller discussion, see Siebert, 2000).

Two counter-arguments can be made. In the first place, empirical research tracking OECD countries over time has shown that high unionisation is associated with increased unemployment, holding other things equal (see e.g. Scarpetta, 1996; Nickel and Layard, 1999). This research thus

backs up the simple analysis of Figure 1. Admittedly, countries with centralised collective bargaining (measured by indexes of centralisation of bargaining – see Flanagan, 1999) have lower unemployment. It looks, therefore, as though centralisation of bargaining can cancel out the effect of high union density in raising unemployment. However, in the second place, high centralisation tends to go together with high taxes, job security laws and generous unemployment benefits. These factors raise unemployment<sup>1</sup>. Thus, while centralised bargaining might be able to offset high unionisation, it can have negative effects on unemployment in other ways.

But free trade unions are a vital factor in a democratic society. At the same time, they can have a negative impact on unemployment. The question posed by the World Bank at the heading of this paper, about how best to integrate trade unions into society, therefore needs to be answered. Each of our nine countries has its methods, more or less successful, as summarised below.

### The comparative picture

Tables 1 and 2 contain comparative data on real wages, unemployment and trade union density in the nine countries. Normally, it would be advisable in particular to analyse employment rather than unemployment figures, since employment figures are generally easier for statistical bureaux to estimate. However, in the case of Brazil, South Africa, and Turkey there are large informal or “grey” sectors, which make employment calculations hazardous. At least unemployment rates can be estimated from sample surveys (whereas total employment cannot). Therefore, we will stick with unemployment measures. Let us look at these tables in turn.

**Table 1: Real wages and unemployment**

Country	Real wage 1998 (1993=100)	Unemployment		
		average 1990-1994	average 1996-1998	change
<b>Australia</b>	117 <sup>a</sup>	8.7% <sup>aa</sup>	8.4%	-0.3
<b>Brazil</b>	125 <sup>b</sup>	4.8 <sup>bb</sup>	6.8	2.0
<b>Ireland</b>	106 <sup>c</sup>	15.6 <sup>cc</sup>	9.6	-5.0
<b>Korea</b>	111 <sup>d</sup>	2.4 <sup>dd</sup>	4.4	2.0
<b>Malaysia</b>	119 <sup>e</sup>	2.9 <sup>ee</sup>	3.2	0.7
<b>New Zealand</b>	103 <sup>f</sup>	7.6 <sup>ff</sup>	7.0	-0.6
<b>Poland</b>	123 <sup>g</sup>	12.1 <sup>gg</sup>	12.8	0.7
<b>South Africa</b>	120 – SA Reserve Bank series <sup>h1</sup>			
	109 – wage settlements <sup>h2</sup>	25 <sup>hh</sup> (African)	28	3.0
<b>Turkey</b>	72 (1997) <sup>j</sup>	8.0 <sup>jj</sup>	6.4	-1.6

### Notes and sources

- a IMF, 1999d, Table 8 – non-farm wages;
- aa IMF, 1999d, Table 6.
- b IMF, 1999e, Table 11, and Weeks 1999 155 – urban wages;
- bb IMF, 1999e – survey data from 6 metropolitan areas.
- c IMF, 1999a, 91;
- cc IMF, 1999a, 92.

- d IMF, 1998d, 10;  
dd IMF, 1998d, 10 and IMF, 2000f, 3.
- e IMF, 1999f, 40 – manufacturing wages;  
ee IMF, 1999f, 38-39 – note: registered unemployment, which is only about 10% of the total.
- f IMF, 1999g, 29;  
ff IMF, 1999g, 31.
- g IMF, 2000c, 66;  
gg IMF, 2000g, 12 – figures are for registered unemployment (however, survey data seems similar – IMF, 2000c, 66).
- h1 IMF, 2000a, 164 – SA Reserve Bank series; h2 IMF, 2000a, interpolated from graph on wage settlements (note Fallon and Lucas, 1998, Figure 3 gives real wage increase in manufacturing as about 7% for Africans 1990-96, and 0% for whites);  
hh ILO, 1999, Table 6 – 25% figure is for 1994. (For white workers unemployment is low, 3-5%, though with an upward trend as well.)
- j IMF, 1998c, 148 – private sector;  
jj IMF, 1998c, 146 – data from a small survey, use with “caution” (1998c, 6); adding on the “underemployed” doubles the rate.

The first column of Table 1 shows the real wage in 1998 compared with 1990. Of course, there are difficulties with measuring the real wage. The concept we aim for here is the urban (or formal sector or manufacturing) real wage. This is the sector which it is most desirable to expand; it is also the sector most organised by trade unions. By looking at changes, we can hope to hold country peculiarities in measuring real wages constant. Even so, South Africa presents problems, with the Reserve Bank estimate (120) differing from other surveys, such as that of Andrew Levy and Associates (IMF, 2000a, 12). Still, if we take the Reserve Bank estimate, then South Africa's real wage increase has been high. It is third highest in the list.

The next columns give unemployment figures. To reduce the influence of special factors (for example, the 1998 Asian crisis's effects on Korea), averages for 1990-94 and for 1996-98 are presented where possible. Unfortunately, this was not possible for South Africa for the earlier period, and the trend increase in unemployment for African workers from 25 per cent to 28 per cent is, therefore, not necessarily reliable. However, it is consistent with South Africa's steady decline in formal sector employment<sup>2</sup>. Taken at face value, the increase in African worker unemployment, 3 percentage points, is the highest on the list. It is hard not to conclude that we are witnessing in South Africa a move akin to that from A to C in Figure 1. However, let us now consider the union density statistics.

Figures for trade union density are presented in Table 2. Taking union density as a percentage of wage and salary earners (the formal sector we are interested in), we see that South Africa has one of the highest densities, 41 per cent. Moreover, South Africa has had the largest increase in union density over the period 1985-95, 23 percentage points. The only country with a similar increase is Brazil (though there are uncertainties over Brazil's 1985 figure), with its new 1988 pro-union Constitution (see Appendix). Both Brazil and South Africa, in fact, have had contemporaneous increases in union power, in real wages and in unemployment.

At the other end of the spectrum are countries which have had real wage increases linked to unemployment decreases – and trade union density decreases. Such a situation would correspond to a move from A to B in Figure 1. Countries in this position appear to be Australia, Ireland, and New Zealand. Poland could also be put in this group, since even though its unemployment increased slightly over the period, this increase was obviously for special reasons and the trend is now firmly downward. In all these countries the trade union movement – while free – has been prevented from wielding undue influence by deregulation (see Appendix).

**Table 2: Trade union density 1985-95**

Country	Trade union density					Remarks (for details see Appendix)
	1985		1995		Change 1995-1985	
	Percent of non-agricultural workforce (1)	Percent of wage and salary earners (2)	Percent of non-agricultural workforce (3)	Percent of wage and salary earners (4)	(4) – (2)	
Australia	41%	50%	29%	35%	-15	Decentralised bargaining since late 80s
Brazil	(13-30) <sup>a</sup>		32	44	16	New pro-union 1988 Constitution after years of military rule
Ireland	41	56	36	49	-7	Deregulation following Thatcher
Korea	9	12	9	13	1	Democracy Declaration in 1987 after military rule, but unions still restrained
Malaysia	14	—	12	13	0	Regime closely controls unions – banned in semiconductor industry <b>New</b>
Zealand	47	54	23	24	-20	Deregulation – Employment Contracts Act of 1991
Poland	44	59	27	39	-20	Fall of communism in 1990 – Poles are pro-capitalism
South Africa	16	18	22	41	23	Fall of apartheid in 1994 as a result of union power has led to union-friendly laws
Turkey	14	21 (25) <sup>b</sup>	22	34 (32) <sup>b</sup>	7	Military rule until 1982 – military still powerful, but becoming less suspicious of unions

### Notes and sources (for Table 2)

ILO, 1998, Table 1.2

a US Department of Labour (1993, 12) gives union density as “13 to 30% of workers legally permitted to unionise”. Taking the average gives 22%, and taking the average of the 1995 figures gives 38%, resulting in a difference of 16 for Brazil.

b Onder, 1999, Table I.1.

### Chapter footnotes

1. Actually, job security laws do not clearly raise unemployment rates, but they certainly raise unemployment duration. The effect on the rate is ambiguous, because job security laws reduce inflows into unemployment, as well as outflows.
2. Fedderke et al. (2000, 8) note that of the 48 manufacturing sectors, 31 had negative employment growth rates 1990-97. By contrast, over the period 1970-90, only 3 sectors had negative growth rates.

### 3 Job security laws

#### The comparative picture

South Africa comes from the Roman-Dutch law/English law freedom-of-contract tradition, so job security laws have not in the past been very important. However, the position has changed with the passing of the 1995 Labour Relations Act with its special Schedule 8 on unfair-dismissal provisions. These provisions carry with them possible damage claims of up to a year's pay for a worker who is unfairly dismissed. The damages increase to two years' pay if the dismissal is "automatically unfair" (that is, affects a protected category of worker such as a striker or is based on anti-union or discriminatory grounds). The 1997 Basic Conditions of Employment Act adds a further new element: severance pay of one week's pay per year of service. The severance pay is meant to be restricted to cases where the worker has lost his/her job through economic restructuring only, not to all dismissals. However, in any disciplinary proceedings now there must be a threat that dismissal could attract severance pay. The severance pay requirement could therefore have quite wide application. In sum, South African businesses have seen an increase in the costs of dismissing and/or downsizing their workforces. The laws also increase the power of unions since participation in a strike is specially protected.

The current comparative picture is given in Table 3. We see that South Africa is not out of line, with an overall strictness of job-security laws score of 1.9 (or 2.2 if we take a wider interpretation of the severance pay exception). Two countries, Korea and Turkey, have higher scores than South Africa, while Poland is approximately the same. To give a context to these measurements, the last column gives the ranking among the 27 OECD members for the OECD members of our group. As can be seen, Poland ranks 12th, that is, a little above halfway in the OECD-27 ranking (towards the less strict end), implying that South Africa also comes a little above halfway in the OECD distribution. To this extent our measurements agree with the IMF quotation at the beginning of the paper, that South Africa's labour legislation is not atypical of that found in many industrial and (rich) emerging economies. However, three problems arise which qualify this conclusion.

**Table 3: Indicators of strictness of job security laws for regular employment, late-1990s**

Country	Regular procedural inconveniences	Notice and severance pay for no-fault individual dismissals	Difficulty of dismissal	Overall strictness of protection against dismissal	Rank in OECD-27 (1 = least strict)
Australia	0.5	1.0	1.5	1.0	4
Brazil	0.5	2.0	2.8	1.8	
Ireland	2.0	0.8	2.0	1.6	8
Korea	3.8	1.8	4.0	3.2	26
Malaysia	1.0	2.5	1.4	1.6	
New Zealand	1.3	1.4	2.3	1.7	9
Poland	3.0	1.4	2.3	2.2	12
South Africa	1.0	1.1 (1.4)*	3.5	1.9 (2.2)*	
Turkey	2.0	3.4	2.5	2.6	19

\* index calculated ignoring the distinction between dismissals for retrenchment, and dismissals for other reasons.

#### Notes on forming the indicators

The indicators are based on scoring countries in areas such as the following: length of notice period, months of severance pay at 3 lengths of service (9 months, 4 years and 20 years); conditions under which dismissals are fair or unfair (a score ranging from 0 when worker capability or retrenchment is adequate, 1 when social conditions or age must be considered, 2 when job transfer or re-training must be considered, 3 when worker capacity cannot be grounds for dismissal, e.g. in Mexico); and

compensation and related remedies (such as reinstatement) following unjust dismissal (in months of pay). These scores and monetary amounts are then averaged using weights as published in OECD, 1999, Table 2.B.1.

### **Notes and sources (for Table 3)**

**Brazil** – Edwards, 1997, 138; Amadea and Camargo, 1997, 226. According to Edwards (1997, 137) “Latin American legislation has a long tradition of protecting job security”.

**Malaysia** – Kuruvilla and Arudsothy, 1995, 179, who state “job security is not well established in Malaysia”; Malaysia Employment Law homepage, <http://www.lawyerment.com.my>.

**South Africa** – Labour Relations Act Schedule 8 (Code of Good Practice Dismissal), and Basic Conditions of Employment Act. Schedule 8 allows for fair dismissals provided the process is fair (including allowing a trade union representative to advise the worker). However, in the case of unfair dismissals, the Labour Court must order reinstatement unless the employee does not want it, or it is impractical, or the dismissal is procedurally unfair only.

**Other countries** – OECD, 1999, Table 2.2 and Appendices 2A and 2B.

### **Adjustment**

In the first place, while the level of South African job security protection may not be atypical, the recent increase in this level certainly is. The OECD study (1999) shows that for OECD members the ‘strictness of job security’ indicator has not changed much over the last decade. The Heckman and Pages (2000) study of 22 Latin American countries shows the same thing. These countries have thus had time to adapt to their job security laws, in particular by restricting union power (since unions can monitor job security laws zealously). For example, Korea and Turkey – with high job-security scores – both have weak union movements. By contrast, South Africa has changed from quite unregulated job security to approximately average OECD regulation. Moreover, this high job security is coupled with South Africa’s historic system of industrial/bargaining councils, which deliver high union power. Therefore, a shock is to be expected.

The view taken here, that South Africa has made a large increase in the strictness of its job security legislation, is at variance with the IMF (2000a) view. According to the IMF study (2000a, 36), the 1997 Basic Conditions of Employment Act simply builds on a previous Act with the same aim. For example, it establishes a working week of 45 hours compared with 46 previously, and requires 21 days annual paid leave instead of the 14 previously. However, the severance pay requirements of the 1997 Act are entirely new. Moreover, the IMF study (2000a, 34) says the 1995 Labour Relations Act does not differ in its “core principles” from its predecessor in that both promote collective bargaining, and the new bargaining councils simply replace the old industrial councils. This statement is true as far as the promotion of collective bargaining is concerned. However, again the dismissals provisions contained in Schedule 8 of the 1995 Act are entirely new. The point remains, therefore, that a shock has been delivered to the system.

### **Uncertainty**

In the second place, job security regulation “bites” most when times are uncertain. It is when businesses are changing their product lines or methods of organisation (for example, outsourcing rather than making in-house) that they most need the insurance of labour flexibility. On the other hand when times are certain, layoff costs are a problem of the distant future and can be well discounted. A related argument here is that job security regulation slows the reallocation of labour from declining sectors to new and dynamic sectors. Labour is allocated inefficiently. Hopenhayn and Rogerson (1993) model this process. The inefficiency matters more when an economy is subject to change.

Nickell and Layard (1999, 3063) point out that job security laws need not slow labour reallocation much in practice because firms can rely on workers leaving of their own accord. Even long job tenures of 10 years or more, which are typical in Europe, imply high voluntary worker-turnover rates (quits and retirements) of 10 per cent a year. Hence it might be thought that firms have room for manoeuvre despite restrictions on dismissals. However, two reservations should be entered here.

First, much of a typical firm's worker-turnover is accounted for by a minority of workers in peripheral jobs. Quit rates among permanent workers are low in the protected European environment, less than 1 per cent per year (Morton and Siebert, 2000, Table 1). Second, when reemployment prospects are uncertain, worker quit rates tend to decline. In times of high unemployment, then, job security laws can act as a barrier to labour reallocation.

Currently, South Africa is obviously facing uncertain times. It might also be true that the dynamic problems facing the economy – if only from globalisation – are greater than before. Therefore the job security laws can be expected to bite.

### **Worker preferences**

Third, should South Africa be aiming to place itself at the average level of job security when compared with a group of rich countries such as the OECD? Jobs provide both money and non-money compensation. Under the non-money heading come factors such as job security and workplace safety. Generally we would expect a trade-off between the two forms of compensation: the more non-money, the less money. Effectively, South African legislators have decided to move along the trade-off in the direction of more non-money compensation.

However, we would expect non-money compensation to be a normal good. The better-off workers – and countries – will choose to take some of their compensation in non-money form, but poorer workers will choose money. Standard economic theory predicts that poorer workers, for example with lower productivity due to less education, will choose to have money compensation rather than good working conditions (see Siebert and Wei, 1994). Put simply, poor workers need the money to pay the rent. A good example is workplace safety. Workplace injury rates (OECD, 1989, Chart 4.4) were around 100 per person employed in Portugal in the late 1980s, 70 in Spain, and only around 40 in the rest of Europe and in the U.S. This pattern of differences follows the pattern of worker earnings in these countries, with the poorer countries having more accidents. South Africa is a relatively poor country. Hence, it is likely that South Africa's majority, poorer, citizens would prefer to move along the trade-off in exactly the opposite direction to that chosen by their legislators.

### **Impact**

Results for the impact of job security legislation on employment and unemployment are mixed, in part because such legislation reduces inflows into – as well as outflows from – unemployment (see footnote 2). It is also difficult – as can be seen from Table 3 – to measure the many dimensions of job security laws.

Nevertheless the latest study, by Heckman and Pages (2000), points to possible serious consequences. Heckman and Pages develop a new index of job security which they use to explain employment and unemployment in a dataset of 22 Latin American countries plus the OECD countries over the 1980s and 1990s. Using their estimates (2000, 20), we can calculate that the Brazilian level of job security (which is similar to the South African level – Table 3) causes a loss of employment equal to about 4 per cent of the workforce.

Thus the reduction in employment in South Africa due to job security laws could be of the order of 4 per cent, using the latest research results. Indeed, the effects could well be larger in the South African case. The 4 per cent figure does not take into account the extra adjustment losses that will be felt in South Africa because the legislation is new. Nor does it take into account the likely stricter monitoring of job security provisions in South Africa given its higher union density. Nor does it take into account the extra "bite" of the laws due to South Africa's higher unemployment.



## 4 Other factors: Minimum wages, taxation, and education

The final section of this paper considers broader topics, including the magnitude of foreign direct investment inflows (FDI) and the importance of education. High FDI inflows are obviously important for employment. (FDI inflows are a factor shifting the D curve outwards in Figure 1.) In turn, high FDI flows might be encouraged by a well-educated workforce. The discussion is based on Table 4, which we will go through column by column.

**Table 4: The labour market environment**

Country	FDI inflows <sup>a</sup> , US\$ per capita per year		Minimum wages (as % of average manufacturing manual earnings, 1997) <sup>k</sup>	Tax measures		Education, enrolment rates, 1995 <sup>l</sup>	
	1993-5	1996-8		Total tax revenue as % of GDP <sup>g</sup> , 1997	Payroll tax rates, as % of gross wage <sup>j</sup>	Secondary	Tertiary
Australia		US\$350	Yes (56%)	30%		147%	72%
Brazil	< \$50	100-150	Yes – since 1940 <sup>b</sup>		35	38	11
Ireland		650	Yes – since 1998 (58)	33	20	115	39
Korea	< 50	50-100	Yes – since 1986 <sup>c</sup> (33)	21		101	66
Malaysia	200	150-200	No <sup>d</sup>		25	59	11
New Zealand		650	Yes (50)	36	10	116	66
Poland	50-100	100-150	Yes <sup>e</sup> (52)	41		98	26
South Africa	< 50	< 50	Yes	30 <sup>h</sup>		82	16
Turkey	< 50	< 50	Yes – since 1965 <sup>f</sup> (30)	28		53	18
UK		2000	Yes – abolished in 1993, restored in 1998 (48)	35	18	134	48

### Notes and sources

a IMF, 1999h, 44; OECD, 2000, 24.

b Amadeo and Camargo, 1997,222 – the real minimum wage has not kept pace with inflation. See also ILO, 1995a.

c ILO, 1995b.

d Arudsothy and Littler, 1993, 127 – however, trade unions have made “repeated requests” for a national minimum wage.

e IMF, 2000c, 83.

f IMF, 1998c, 148.

g OECD (1999) Revenue Statistics 1965-98, Table 1.

h IMF, 1998e, 7 – figure is for national government expenditure as percent of GDP.

j Edwards, 1997, 142.

k Martin, 2000, Table 3.2.

l Unesco, 1998 – figures give total enrolment in secondary schools as a percentage of those in the official age groups for secondary education, hence the rates can be above 100%.

The first columns give the FDI inflows per capita per year for the nine countries. (The UK is given as a point of reference.) South Africa, Turkey, Brazil and Korea have the lowest inflows, New Zealand and Ireland the highest. In fact, FDI inflows are well correlated, negatively, with trade union growth, with the job-security strictness score, and with unemployment growth<sup>1</sup>. The implication is that trade union power and strict job security have adverse effects on FDI inflows. As might be expected, high FDI inflows reduce unemployment.

The next columns give some data on minimum wages. Only Malaysia does not have a minimum wage. The UK and Ireland have restored their minimum wages. It seems next to impossible, politically, to avoid the minimum wage. However, the level of the minimum is important. Here it is interesting to contrast Korea with a low minimum (33 per cent of full-time manual earnings) with Ireland (58 per cent).

The next column gives data on the tax burden, since high levels of tax have adverse impacts on job creation, other things equal (see e.g. Scarpetta, 1996). We would expect high taxes to deter FDI unless tax breaks are given, as has been the case so successfully in Malaysia (see the Appendix). The tax burden is difficult to measure outside the OECD countries, especially for Brazil and Malaysia. Hence, in addition to tax revenue as a percentage of GDP, the table presents a further measure for these countries. The conclusions that can be made are that Brazil is highly taxed, with a payroll tax alone of 35 per cent; Korea is lightly taxed, with a tax percentage of 21 per cent; South Africa and Malaysia are probably in the middle.

The final columns present measures of educational attainment. Education is fundamental to labour productivity and thus to the wage that workers can command – or which they can trade for better job security. Brazil seems very low, with a secondary-school enrolment rate of only 38 per cent. (The figure given is the total enrolled in secondary school, divided by the population in the official age group for secondary school; hence, the figure can be above 100 per cent.) Turkey comes next, then South Africa and Malaysia. At the other extreme are Australia, Korea and New Zealand with around 70 per cent enrolment rates at the tertiary level – better, even, than the UK. Education levels correlate positively with FDI inflows, suggesting that investors find it more attractive to invest when the population is educated. The conclusions that can be made here are that – while South Africa's education fundamentals need improving – there are other industrial countries that are far worse. Malaysia is a by-word for FDI, and yet its education fundamentals are considerably worse than South Africa's.

1. Rank correlations between change in unemployment (dU), change in real wages (dW), FDI, change in union density (dT), enrollment rate in secondary education (E), and the job security indicator (JS) are:

	dU	dW	FDI	dT	E	JS
dU	1.0	0.73**	-0.55	0.74**	-0.36	0.35
dW		1.0	-0.19	0.21	-0.37	-0.04
FDI			1.0	-0.72**	0.63*	-0.78***
dT				1.0	-0.69**	0.35
JS					1.0	-0.42

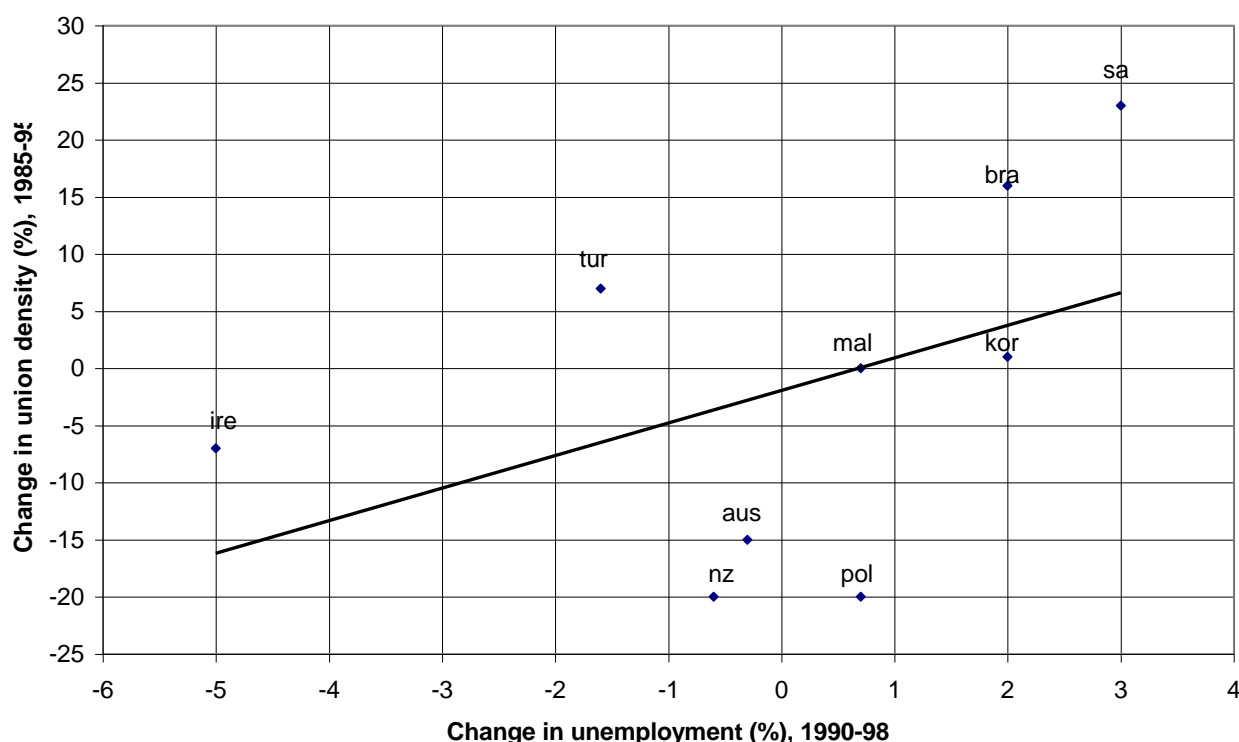
(\*\*\*, \*\*, \* denotes significance at the 1%, 5% and 10% levels.)

## 5 Summary and conclusions

Let us look back through our tables in turn, and briefly summarise the conclusions. Table 1 shows South Africa to have had relatively high increases in both unemployment and in real wages. We ascribed these to South Africa's increase in union density (Table 2). South Africa appears similar to Brazil in this respect. At the other end of the spectrum are Australia, Ireland and Korea, all of which have had real wage increases but unemployment and trade union density have fallen. We concluded that it was vital to find a way of combining free trade unionism with reduced union wage-setting power.

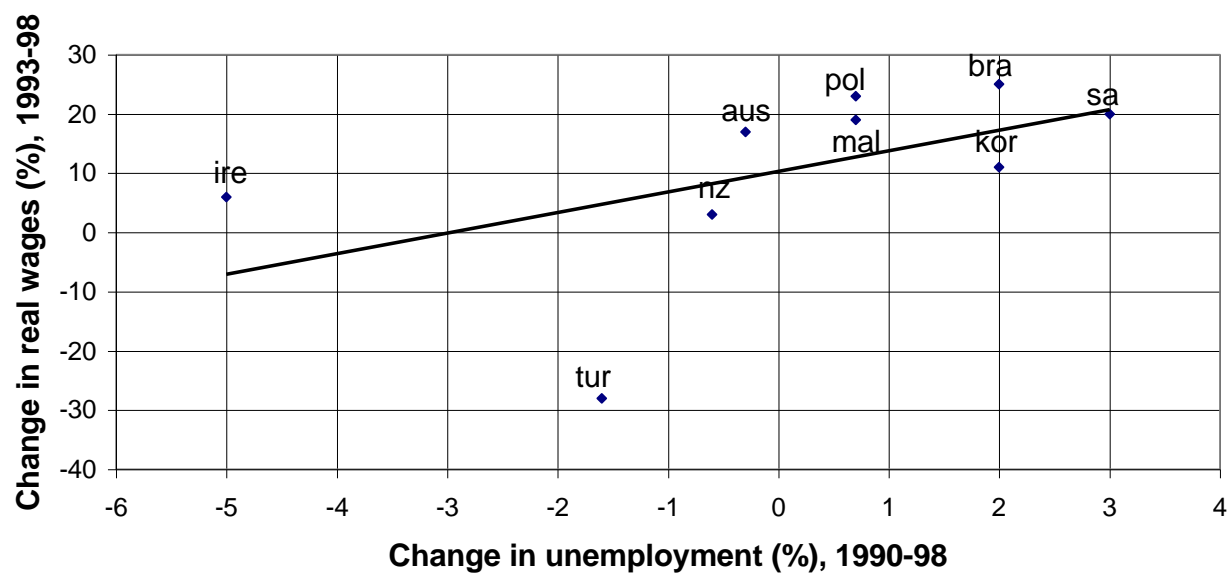
The links between wage increases, strong trade unions, and high unemployment are brought out well in Graphs 1 and 2. Graph 1 shows how South Africa and Brazil have both had high wage increases and suffer consequent high unemployment. Graph 2 shows how South Africa and Brazil have similarly had high increases in union density.

**Graph 1: Strong trade unions and high unemployment**

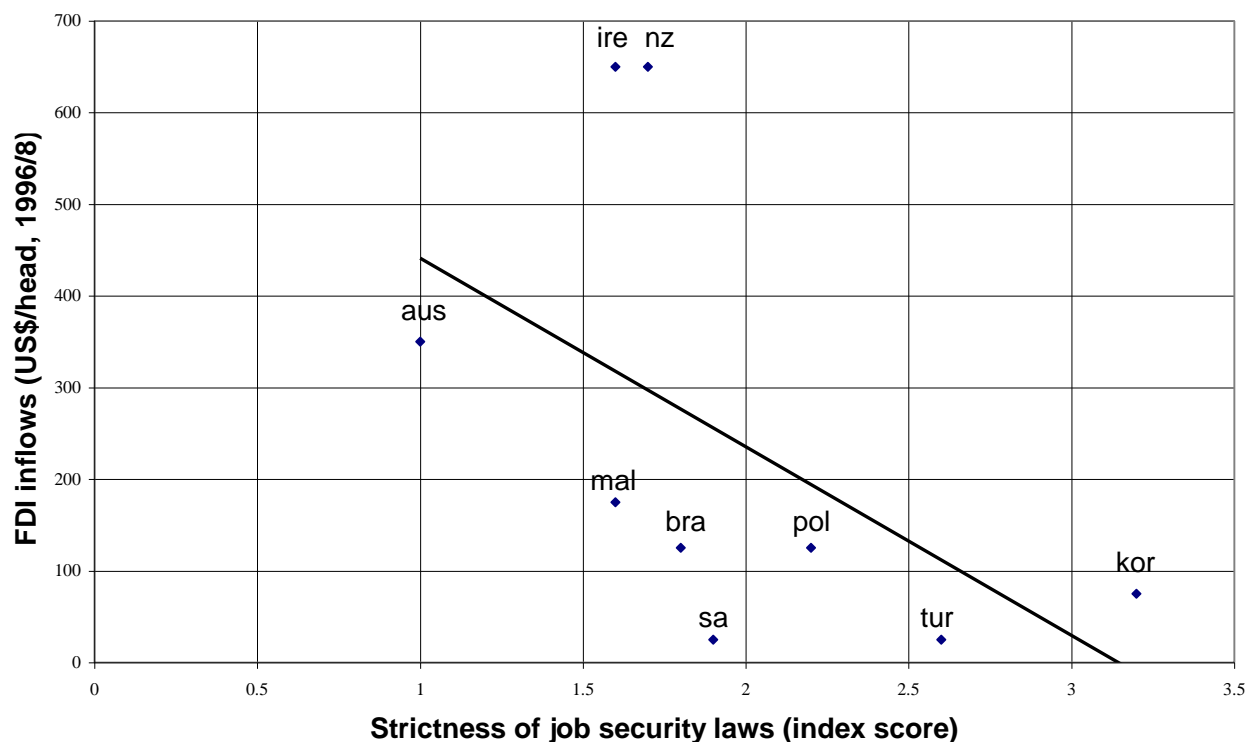


Turning next to job security (Table 3), we found that South Africa was about average when ranked against the OECD job security indicator. We saw major problems with this position. In particular, a middle rank amongst the OECD rich countries is too high for a relatively poor, relatively uneducated (Table 4) country like South Africa. Increased job security is costly and reduces business flexibility. These costs require a wage fall which poor countries (and people) can ill afford. Moreover, if wages are prevented from falling, unemployment ensues and foreign investors are put off. It must also be remembered that in South Africa the job security requirements are coupled with a strong union movement which will ensure the requirements are monitored and met (unlike, say, in Korea or Malaysia).

**Graph 2: High wage increases and high unemployment**



**Graph 3: The negative link between job security laws and FDI**



Graph 3 shows the strong negative link between FDI and the strictness of job security laws. The graph is only intended to be suggestive, since many factors influence FDI apart from job security laws. Nevertheless, it is interesting that the countries which have the strictest laws, also tend to have the least FDI.

On the education front, the picture is more encouraging. South Africa has better education fundamentals than Brazil and Malaysia. Malaysia's FDI and employment success is in fact an object lesson on what can be done from a low education base. However, Malaysia has a repressive policy towards unions, quite unlike South Africa, which brings us back to the main issue.

The main lesson from this paper is that South Africa must control the power of its trade unions. However, it has to be acknowledged that, given the unions' prestige and political power, it is unthinkable that union density can be assailed. Hence a second-best solution must lie in devising ways to ensure that the union power is exercised more responsibly. A corporatist solution, on Dutch lines, might work. In this scenario, a central forum is established in which trade unions, business and government negotiate directly over an economy-wide wage-increase figure. Such a forum has an educative role for the trade unions, making the trade-offs in Graphs 2 and 3 apparent. Obviously moving towards such a solution will not be easy, and there are dangers in it too. Nevertheless, this paper has highlighted the problem of strong trade unions. The next step for those with South Africa's prosperity at heart is to work out the solution.

# Appendix

## Labour market background summaries for each country

### Australia

Australia has long had a centralised quasi-judicial wage-setting system based on the 1904 Conciliation and Arbitration Act which provides for state and Federal arbitration awards. Only registered trade unions have the right to be heard by the arbitrator, and have protected strike rights. The resulting awards apply to the whole occupation/industry and effectively act as a minimum wage with little allowance for local conditions – apart from “over-award” wage increases when awards fail to keep up with inflation. In the 1980s, about 85 per cent of the workforce were covered by state or Federal awards (Upham, 1993, P-04). A minimum wage is also set by the Commission, and Victoria and Tasmania have their own minimum wage-setting machinery for industries with low unionisation (Dufty, 1981, 13).

There have been changes in the last decade, leading to more decentralisation. The 1988 Industrial Relations Act allowed companies to make local agreements subject to the approval of the Australian Industrial Relations Commission (the chief arbitration body). This process was carried further by the 1993 Industrial Relations Reform Act and the 1997 Workplace Industrial Relations Act. However, according to Davis and Lansbury (1998, 139), workplace agreements have grown only slowly.

### Brazil

Brazil's development of labour law and trade union movement is similar to Spain and Portugal. All these countries have been subject to military rule which has been antipathetic to freedom of contract. The military have controlled the trade unions, at the same time regulating working life. In the case of Brazil, first there was Getulio Vargas (1930-45 and 1950-54), and then the military took power again from 1960 to 1982. Vargas provided for trade unions to have state finance (one day's pay per year from each worker) but also controlled their objectives – which did not include strikes. He was also responsible for the 1943 Consolidation of Labour Laws (Alexander, 1981, 54-59), which set up tripartite “labour courts”, brought in “estabilidade” (complete security of tenure for workers with more than 10 years service), and began a minimum wage. Although the estabilidade system was replaced by a severance pay fund by the generals in the 1960s, job security laws in Brazil are well established.

Civilian rule was restored in 1982, and so Brazil adopted a new Constitution in 1988 which permitted trade unions more freedom. This freedom was partly a reaction to the years of military suppression, and also in recognition of the fact that the unions had been major opponents of the military. The union movement is militant and – while split along ideological lines – has been successfully slowing down the privatisation programme.

### Ireland

Ireland has a similar freedom-of-contract tradition to the U.K. It has a similar history of occupationally-based trade unions and, in fact, many Irish unions have their head-offices in the U.K. When Thatcherism weakened the British unions, this had repercussions in Ireland.

The important aspect about Irish development over the past two decades has been her membership of the EU. For many years, the EU has provided grants to Ireland amounting to as much as 4 per cent to 5 per cent of Irish GDP, and grants at this level continue (IMF, 1999a, 101). Growth has consequently been good, helped by tax concessions to newly-established foreign companies which in fact contravene the competition rules of the EU (see the EU Seventh Survey of State Aid to Industry, 1998).

### Korea

Korea, like Brazil, has suffered several periods of military rule with accompanying repression of trade unions and paternalistic setting of labour standards. The Republic of Korea dates from 1948, with the Korean War lasting until 1953. After the war the Labour Union Act, Labour Disputes Mediation Act and Labour Standards Acts were passed, modelled on Japanese practice (Park and Lee, 1995, 31). The concepts of the permanent employee and the enterprise union – with union officials paid by the company – date from this period (Ogle, 1981, 501). In the turbulent period (Korea has had six Republics) preceding the return to democracy with the 1987 Democratisation Declaration, “labour repression was seen as an economic necessity” (Park and Lee, 1995, 34). Official suspicion of trade unions continues to some extent today. For example, the 1997 Trade Union Act confirms that teachers cannot be members of trade unions.

Korea’s growth has been shaped by the family-run Chaebols. These were favoured by government preferential loans and sheltered from foreign competition as engines of export-led growth beginning in the 1960’s (IMF, 1998, 3-29). 40 per cent of manufacturing output and 16 per cent of GDP is produced by the top 30 Chaebols (IMF, 2000b, 91). These giant companies are in financial difficulties with debt ratios of over 400 per cent which would be unsustainable without their close government connections, with Chaebol family members also high government officials.

### **Malaysia**

Malaysia is similar to Korea in the sense that it has a history of authoritarian governments which believe in both export-led growth planning and reducing the power of unions. Soon after independence in 1957, Malaysia passed the 1959 Trade Union Act which required unions to register. The Registrar has used his power to promote company unions and prevent unions in East Malaysia joining with West Malaysia. He has also banned unions altogether (until 1988 – and then only in-house unions) from the successful electronics and semiconductor industry (Kuruvilla and Arudsothy, 1995, 169). In 1991 the Prime Minister, Mahathir Mohammed, even denounced ILO and American union (AFL-CIO) pressure to reverse the Registrar’s stance on unions in the semiconductor firms. He said this pressure was “an imperialist plot by the West to ruin Malaysia’s economy” (Upham, 1993, I-47).

Malaysia’s 1971 New Economic Policy favoured Malay ownership and control of business, and the government assisted in this. The consequence, as in Korea, is dominance of business by a few large family-owned firms: 30 per cent of market capitalisation is controlled by 15 families (IMF, 1999b, 78). At the same time such concepts as “Pioneer” status for incoming firms, with tariff protection and tax exemption for 5-10 years, have been successful in attracting foreign investment. Malaysian accounting standards are good, and privatisation has reduced 1400 state-owned firms in 1991 to about 30 currently (IMF, 1999b, 76). There has been a fall in the 20 years to 1995 from 59 per cent to 16 per cent of rural households below a poverty line of US\$1 a day per person in 1995 prices (IMF, 1998b, 4). The fall was mainly during the period of the New Economic Policy

### **New Zealand**

New Zealand is like Australia in its historic reliance on compulsory arbitration, which dates back to 1894. New Zealand, however, since 1984’s Labour Party victory (with Roger Douglas the Finance minister), has much more decisively rejected the corporatist model. In 1987, the Labour Relations Act removed the government’s role in enforcing arbitration awards. Then in 1991 the Employment Contracts Act made a complete break: it made closed-shop arrangements unlawful and ended compulsory arbitration. Consequently, union membership fell 50 per cent (Haworth, 1993, 300). Also the Labour Court’s role in upholding grievances and preventing dismissal was reduced because it could only consider questions of law, not points of fact (Upham, 1993, P-21). A further change was the Reserve Bank Act which established an independent central bank and achieved low inflation. In addition, there was some privatisation and some tariff cutting. However, deregulation of the monopoly agricultural producer boards has not occurred (IMF, 1999b, 18).

New Zealand suffered a recession with the Asian crisis, and the libertarian experiment has fallen under a cloud. A new Labour government under Helen Clark aims to re-regulate. An Em-

ployment Relations Bill has been proposed (Financial Times, 3/7/00) which will allow unions to strike in favour of multi-employer agreements. Admittedly the IMF (199b, 17) argues that total factor productivity growth has improved with deregulation: its average was -0.14% pa over 1972-84, 0% over 1984-93, and then 1.5%pa over 1993-98. FDI inflows have also been excellent – e.g. as good as Ireland (see text table) – except for 1999. But New Zealand has become relatively poorer over the years (John Kay, *Financial Times*, 30/8/00), and the experiment is being blamed.

## **Poland**

In 1990, Poland became independent after a 10-year campaign by the trade union Solidarity. In reaction to the Communist system, Solidarity endorsed “marketisation” and was against works councils and “democracy in the enterprise” (Weinstein, 1995, 160). Trade unions were organs of the state under communism and have since wished to re-define themselves. The 1991 Trade Union Act gave trade unions the right to bargain collectively, and the 1991 Employers’ Organisations Act permitted the formation of employers’ organisation, whence the Confederation of Polish Employers began (Upham, 1993, E-106). However, the system is only beginning and the unions have not been able to obstruct privatisation. According to the IMF (2000c, 56-61), by 1999 Poland had sold 3000 of its original 8500 state-owned enterprises, liquidated 800, and was in the process of disposing of 1000 more. In 1999, privatisation receipts totalled 2.25 per cent of GDP. By 1998, employment in the “private sector” was 71 per cent of total employment, well up on the 57 per cent prevailing in 1993 (IMF, 2000d, Table 9).

As well as the uncertainties introduced by rapid change, on the debit side Poland has inherited a sort of paternalism from its previous regime. Labour taxes are high – nearly 50 per cent (French levels) – as is the minimum wage. There are generous early retirement and disability pensions, and “abuse of sickness benefits” (an average of 18 days a year per person being claimed in 1998: see IMF, 2000c, 89-90). Agriculture currently employs about 25 per cent, and the market for land is still only half-free. However, the education fundamentals are good.

## **South Africa**

See text.

## **Turkey**

Turkey, like Brazil and Korea, is emerging from a period of military rule. Just as in these countries, the military suppressed free union activity and coupled this with paternalistic wage and job protection, including a minimum wage since 1965. The 1961 Constitution gave the right to collective bargaining (though Kemal Ataturk’s 1930 Penal Code prohibition on strikes remained until 1967 – see Direli, 1981, 548). Collective bargaining was suspended in 1980 after a military coup, the third in 20 years. In 1983, political parties were authorised, and in 1984 collective bargaining resumed. However, the Minister of the Interior can ban a trade union which cannot in any case co-operate with political parties. Public sector strikes are also banned, and disputes have to be referred to a tripartite High Arbitration Board (Upham, 1993, E-148-150).

Turkey has two peculiarities which limit its growth. The first is the suspicion of foreign control, which stems from the Ottoman Empire’s practice of granting monopoly trading concessions (IMF, 1998c, 89ff). This has led the Constitutional Court to strike down several privatisations including at least four attempts to privatise Turkish Telecom. Secondly, it has pension systems which have no minimum retirement age, only a minimum service period of 25 years. The pension systems have large deficits which are met by the government, leading to the 70-80 per cent annual inflation rates currently being experienced.



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