Testimony of Eric T. Miller

President, Millers Rock Consulting, LLC
erictmiller@earthlink.net

to the

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Committee on Financial Services

Hearing on

The Fight Against Global Poverty and Inequality: The World Bank's Approach to Core Labor Standards and Employment Creation

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Mr. Chairman, Members of the Committee, thank you very much for the opportunity to address you this morning.

My name is Eric T. Miller. I am currently President of *Millers Rock Consulting, LLC*, a trade and business strategy firm. Previously, I worked for nine years at the Inter-American Development Bank (IDB), the World Bank's sister institution for Latin America and the Caribbean, and for two years for an economic consulting firm developing business with the World Bank and other donor institutions. I have also run a major USAID trade development project in Panama and have prepared a number of detailed country-level economic and social reports for the Agency that draw heavily on the *Doing Business* report and other indicators. In short, I have seen the "development business" from many different perspectives.

Poverty, Inequality, and the Millennium Development Goals

This hearing is timely and of great importance. As we reach the halfway point in the timeframe established for meeting the Millennium Development Goals (MDG), it is important to have a broad-ranging discussion about where we are with their implementation. A key MDG is to "reduce by half the proportion of the world's population living on less than $1 per day". According to the World Bank's *World Development Indicators* 2007 report, the number of people in the world living on less than $1 per day is falling. In 2004, some 980 million people were suffering in this type of extreme poverty, compared with 1.25 billion people in 1990. The report indicates that the number of people living on less than $2 per day is also falling. However, an estimated 2.6 billion people – or almost half the population of the developing world - are still living below that level. In other words, while we are making progress in the fight against global poverty, we are not moving far enough or fast enough.

The continued urgency of the challenge is even more apparent when one considers where many of those coming out of extreme poverty reside. They tend to be in a handful of populous countries that have achieved high levels of growth as a result of ambitious market opening processes undertaken over the past 15-20 years, namely China and India. By contrast, many countries in the developing world have made scant progress in cutting their dollar-a-day rates. A principal cause for this lack of progress is that hundreds of millions of people in sub-Saharan Africa, the Middle East, and Latin America remain cut off from the global economy and its the economic growth potential. It is little wonder that most of the world's wealthiest countries are also, according to the Foreign Policy/A.T. Kearney list, the most globalized. By contrast, much of the developing world lacks even the basic "plumbing" for making globalization work. This includes quality infrastructure (ports, airports, primary and secondary roads), a wide dissemination of information and communications technologies, an openness to foreign direct investment, capital markets that include the poor, and governance structures that are conducive to private enterprise while providing complementary public goods. Many developing countries also have poor education and training systems, meaning that workers often lack the skills and technical knowledge needed to effectively participate in the global economy above the lowest rung.

Numerous developing countries also have large numbers of businesses in the informal sector that skirt their tax obligations and have a poor record in the treatment of workers. Many of these challenges are contemplated in the MDGs.

While the experiences of China and India in achieving solid growth patterns and large reductions in the levels of poverty should be carefully examined for lessons, the two countries share one thing in common – they are mega-states with large internal markets. By contrast, mid-size and smaller countries must produce for and sell to a global economy if they are to achieve economies of scale. The real success in meeting the MDG on poverty reduction should be measured outside of the emerging mega-states.

Although the MDGs do not establish explicit targets on reducing income inequality, the available evidence suggests that the gap between the rich and poor is increasing in many parts of the developing world. Growing income inequality matters for a variety of reasons, ranging from challenges to social cohesion to the decreasing purchasing power of consumers in internal markets. In addressing the challenges of growing inequality, one must understand its causes. Many economists have attributed the widening of the income divide to a divergence in the economic returns between those that are able and willing to participate in the global economy and those that are not. There is a great deal of truth to this assessment. However, growing inequality is not the result of a conscious decision to make the rich richer and the poor poorer. Rather, it stems principally from the technological changes that have resulted in cheap transportation, instantaneous communications, and the like. Rather than engaging in a quixotic attempt to reverse the technological developments that underpin the global economy or legislate impediments to the flows of global commerce, developing countries and donor institutions need to work together to widen the access of the poor and the lower-middle-class in the developing world to the global economy and to improve the skills and products that they can bring to the table. Widening the circle of wealth creation is the only viable way to reduce inequality. One must be very clear that open markets, open trade, open investment, open travel, the open flow of ideas, and transparency are essential tools for moving large numbers of people in the developing world out of poverty.

What are Core Labor Standards?

Internationally, core labor standards are understood to be the four principles set forth in the 1998 International Labor Organization (ILO) *Declaration on Fundamental Principles and Rights at Work.* While the ILO has Conventions dealing with a variety of topics, the 1998 Declaration established that the four principles were the basic standards by which members had to comply. The Declaration enjoyed wide support from the United States and many other countries. In the end, the 175 ILO member states as well as representatives of employers and workers supported the Declaration.

The four core labor standards are:

(1) ***The elimination of all forms of compulsory labor***. This includes any work or service, paid or unpaid, that is performed involuntarily or under threat of penalty, such as indentured labor, bonded labor, or forced prison labor;

(2) ***The effective abolition of child labor, with priority to the worst forms***. This includes both the traditional emphasis on limiting hours, times, and ages of work as well as more contemporary issues such as using children in illicit activities or activities that endanger the health, safety, and morals of children;

(3) ***The elimination of discrimination in employment***. This includes the elimination of discrimination in access to employment, training, and working conditions on the basis of race, color, sex, religion, political opinion, national extraction, and/or social origin. It also includes a requirement for equal pay for men and women for work of equal value; and

(4) ***Freedom of association and the right to collective bargaining***. This includes providing protection against interference of workers' and employers' efforts to organize and protects measures promoting collective bargaining. Additionally, it prevents employers from conditioning employment on workers pledging to not join or to relinquish membership in a union and from dismissing or otherwise punishing a worker due to union activities.

Core labor standards have also been widely discussed in the context of trade negotiations. Many analysts attribute this to the perceived institutional weakness of the ILO on the enforcement side as compared to the relatively strong dispute settlement provisions at the WTO and in regional trade agreements.

The World Bank and Core Labor Standards

The World Bank has not defined an official policy on core labor standards nor has it mandated full compliance with core labor standards as a condition for loans, grants, or technical assistance to client countries. However, it has undertaken a variety of initiatives to support the universal implementation of core labor standards in response to both the 1998 ILO Convention and the 12th and 13th Replenishments of IDA Resources. First, the Bank assembled a Core Labor Standards Toolkit, which is designed to assist staff in addressing these issues in the development of Country Assistance Strategies (CAS) – the basic strategy document with each country. There is evidence to suggest that the implementation of the core labor standards is finding a place in the CAS documents in numerous countries. For example, the 2005-2008 CAS for Cambodia establishes that a lack of compliance with core labor standards is a key impediment to productivity growth. Second, compliance with core labor standards has been incorporated into the Country Policy and Institutional Assessment (CPIA) documents that are used to assess the quality of IDA country policy frameworks with a view to informing the allocation of these resources. Third, the IFC and MIGA have policies forbidding harmful child or forced labor in investor projects. Fourth, the Bank undertakes ongoing policy dialogues, training programs, and initiatives supporting the implementation of the core labor standards.

Examples include the Bank's ongoing program on child labor and a pilot project strengthening core labor standards in three African countries.

The Doing Business Report

On September 25, 2007, the World Bank released the 5th Edition of the *Doing Business* report. The Bank states that the basic objective of this annual report is to investigate "the regulations that enhance business activity and those that constrain it. *Doing Business* presents quantitative indicators on business regulations and the protection of property rights that can be compared across 175 economies … and over time."

Doing Business determines its rankings based on ten major categories: (1) Starting a Business; (2) Dealing with Licenses; (3) Employing Workers; (4) Registering Property; (5) Getting Credit; (6) Protecting Investors; (7) Paying Taxes; (8) Trading Across Borders; (9) Enforcing Contracts; and (10) Closing a Business. These categories are, in turn, comprised of a total of 42 sub-categories of indicators.

The data is collected on the basis of annual surveys, completed principally by law and consulting firms in the countries. While the *Doing Business* team has set forth its methodologies for collecting the data for each category in peer reviewed journals and have otherwise made efforts to ensure its accuracy and comparability, survey data of this nature is inherently imperfect. For example, in 2006, when I was preparing a country social and economic assessment for USAID, the Economic Growth Officer in the Country Mission told me that only four lawyers in his country had completed the surveys and the results for some categories were overstated. Nevertheless, the *Doing Business* results do appear to be sufficiently accurate to constitute a reasonable approximation of the regulatory environment for business within and across countries.

Employing Workers

The *Employing Workers* category, which includes six sub-categories – (a) Difficulty of Hiring Index; (b) Rigidity of Hours Index; (c) Difficulty of Firing Index; (d) Rigidity of Employment Index; (e) Non-wage labor cost (% of salary); and (f) Firing costs (weeks of wages) – has been the subject of some controversy.

The basic assumption of the Bank is that flexible labor markets are more conducive to job creation than rigid labor markets. There is wide evidence in the economic literature and in the experiences ranging from wealthy countries such as Germany to poor countries such as Burkina Faso that flexible labor markets lead to job creation. As the 2006 *Doing Business* report aptly explains:

> *With rigid regulation, common in developing countries, employers choose conservatively. Some workers benefit – mostly men with years of experience on the job. But young, female and low-skilled workers often lose out, denied job*

opportunities. Inflexible labor markets stifle new job creation and push workers into the informal sector. Three-quarters of informal workers are women. They receive no health benefits, no support for their children, no sick leave, and no pension. If abused by their employer, they have no recourse to the courts, because the employment relationship is not documented. Far from protecting the vulnerable, rigid employment regulations exclude them from the market.

Some have raised concerns about whether the Bank's methodology encourages countries to not fully comply with core labor standards by grading them higher if they do not. However, this assertion is unfounded. Nothing in the World Bank's approach suggests that they understand flexible labor markets to mean the absence of labor law. The Bank views practices such as child labor or forced labor as injurious to development. In addition, the Bank, like virtually every other development agency recognizes the importance of ensuring equal rights for woman and minority groups to the development process.

Doing Business and Unions

The World Bank has not taken a position on the effects of the role of unions in the *Doing Business* report or elsewhere. Some observers have raised concerns about certain cases where countries with more restrictive union organization practices score better than those with less restrictive practices. This result is due to the focus of the study and the methodology employed for gathering the data. This is also the case for countries such as Saudi Arabia, which are well known for their poor treatment of women, yet score well. The *Doing Business* report focuses on measuring the impact of regulations on business formation and operation across 175 countries. It does not focus on the impact of unions or the effect of tax incentives or any other type of measure that could have specific effects in specific countries. In order to make data comparable across countries, large and small, rich and poor, and with different legal traditions, the standard practice is to develop a basic typology for each category in the survey. In the case of "Employing Workers", the survey assumes, *inter alia*:

The Worker:

- *Is a 42-year-old, non-executive, full-time, male employee.*
- *Is not a member of a labor union, unless membership is mandatory.*

The Business:

- *Is subject to collective bargaining agreements in countries where such agreements cover more than half the manufacturing sector and apply even to firms not party to them.*
- *Abides by every law and regulation but does not grant workers more benefits than mandated by law, regulation or (if applicable) collective bargaining agreement.*

Certainly most workers are not 42-year-old males, and many workers are members of unions. However, in order to obtain an average picture that is comparable across countries, one must make assumptions about what a “typical” worker and business look like. In most countries, the majority of workers are not union members. Therefore, the “typical” worker is not a union member. Were the World Bank team to begin to differentiate between male and female workers, union and non-union workers, and rural and urban workers, to name but a few, *Doing Business* would lose its focus and swiftly become non-comparable across countries.

The Uses of Doing Business

Some observers have expressed concerns that private investors and the Bank itself evaluate candidates for investment on the basis of the *Doing Business* report without fully understanding or explaining the assumptions in the methodology. Certainly the release of this annual report is accompanied by the plethora of media activity. However, the impact of the report, especially on private investors should not be overstated.

In my years of experience in working on foreign investment issues in the Americas, I have never observed an investor who would invest in a country solely on the basis of an international report. Firms invest outside their home countries for a variety of reasons. The typology advanced by the UN Economic Commission for Latin America and the Caribbean is helpful in this regard. It posits that there are three motivations for foreign investment:

- efficiency-seeking: looking to build products or provide services better and more cost effectively;
- raw materials-seeking: including sectors such as mining, oil/gas, and forestry;
- market access-seeking: looking to sell into less open markets or heavily regulated sectors.

Even after firms know why they are investing, the decision of where to invest tends to be made following an extended evaluation process. Most companies consider a variety of factors including the procedures for establishment in the country, the tax regime, the ability to repatriate profits, energy costs, and the quality of infrastructure for moving goods into and out of the country. Although labor costs and the labor regime are considered in the evaluation, they are but two of many factors. This is especially true outside of the Chinese manufacturing sector and the Indian services sector. While investors do look at many of the regulatory issues covered in the *Doing Business* report as part of their due diligence process, their examination is much deeper, more extensive, and sector-specific than that of the World Bank team. In short, investors are concerned about the particular regulatory regime in the particular part of the economy in which they are seeking to operate.

The most important contribution of the *Doing Business* report at the country-level is that it has made governments begin to think about the incentive structures inherent in their business regulatory regimes and how these can be improved. For years, many countries have made it expensive and complicated for entrepreneurs to establish and operate firms in the formal sector. Everyone agrees that it is desirable to have more tax-paying firms that employ people, help contribute to the social security coffers and the like. However, national regulatory regimes that make the formalization process long and expensive drive firms underground or kill them altogether before they ever get started.

The Equator Principles

The Equator Principles are the culmination of years of work by the banking industry to develop a universal framework for addressing social and environmental issues that arise in their projects. Banks now have a common framework for assessing such risks as well as a common terminology. The Principles were first launched in 2003 by ten commercial banks. Today, more than 50 banks representing well over 80% of global project lending have adopted them. The Bank's International Finance Corporation provided important advice and support to the process of putting the Principles together. Its most important contribution was to serve as the source for the environmental and social framework on which the Principles are based.

The Equator Principles are a welcome initiative. Importantly, participation is voluntary. Firms are required to notify that they have put in place the procedures to adopt the Principles. However, they are not required to sign a lengthy agreement and subject themselves to potential legal action in the case of disagreements about their level of compliance. Were compliance subject to such an agreement, one can posit that banks would be less inclined to join. Through voluntary standards and required annual reporting, the global financial industry is making important progress in addressing social and environmental issues in the projects they finance.

Unions in Developing Countries

There is no consensus about the economic effects of unions in developing countries. Classical economic analysis holds that unions interfere in the labor market price setting process, thereby creating market inefficiencies and reducing firm-level profits. Other economists hold that unions bring increased wages in their sectors and promote firm level investment. More broadly, there are certainly examples such as Solidarity in Poland and the Congress of Trade Unions in Zimbabwe where unions have and are playing a positive role in the democracy-building processes in their countries. Similarly, there are also numerous examples throughout the developing world of union corruption. Assessing the positive and negative effects of unions is ultimately the job of citizens and companies. However, in this debate, one must not lose sight of the fact that if firms cannot compete in the global economy, there are no jobs.

The World Bank, Poverty Reduction, and Labor Standards

The World Bank is a large, diverse organization offering its member states a range of tools including loans, grants, technical assistance, guarantees, policy analysis, and training. The Bank system has a diverse array of institutions and mandates that have been accumulated at the direction of the board over many years. In pursuing its many objectives, the Bank tries, in general, to incorporate approaches that are found through research and experience to “work” in achieving its goals. Like any large bureaucracy, the results are imperfect and uneven. The *Doing Business* report is a notable exception to this “bureaucratic” tendency. As part of the process of exploring ways to make the Bank better and more efficient at achieving its overarching mission of a world free of poverty, we must think about how to improve its capacity to work with entrepreneurs and businesses trying to innovate and make the leap to exporting and greater levels of competitiveness. This not to imply that Bank’s continued work on infrastructure, education, and policy reform projects is not important. It certainly is. However, they must be understood as the necessary frameworks that support the creation of competitive firms, competitive products and services, and skilled workers.

On the issue of core labor standards, the World Bank should explore ways of doing more. Some of the regional development banks are more active in this area than the World Bank. For example, the Inter-American Development Bank played a very important leadership role during the CAFTA process in pulling together trade and labor ministers to focus on improving compliance with core labor standards and the enforcement of domestic labor laws. Anecdotal evidence suggests that the monitoring and transparency demanded by CAFTA has led to an improvement of labor conditions in the six countries. Likewise, the Asian Development Bank recently produced a handbook on incorporating core labor standards into its programming process that goes much beyond the earlier World Bank toolkit.

While the IFIs can look to do more in the labor area, the impetus for improvement of labor standards will come at the country level. Having seen numerous manufacturing jobs go to China, many developing countries now understand that low wages are neither a desirable nor a feasible strategy for long-term competitiveness. Thus, development agencies, government authorities, and firms are working together to assist the latter with moving up the value chain where they can compete on the basis of factors other than strictly price. With higher-value products and services come higher wages and improved working conditions. While this process takes time and challenges remain, large-scale poverty reduction will only come by providing the poor with the access and the tools to take advantage of the global economy markets.

Thank you very much for your time.