



SECOND ITEM ON THE AGENDA

Policies and social partnerships for good governance**I. Introduction**

1. Following the Working Party discussion at its March 2003 session, the Officers of the Governing Body asked the Office to prepare a paper focusing on two aspects highlighted in the earlier document on governance, social partnership and globalization:¹
 - (a) a more detailed examination, based on a review of successful experience, of how effective social partnership can contribute to other aspects of good governance such as sound economic management and improved corporate governance;
 - (b) a substantive review of the literature of the determinants of good governance and the policy guidelines that can be derived from this research.

The space limitations on the present paper permit treatment of only the main aspects of this extremely wide-ranging debate.

2. “Social partnership” was referred to in the earlier document² as “collaborative relationships between governments and employers’ and workers’ organizations to achieve mutually agreed economic and social objectives”. As a type of social dialogue, social partnership can be tripartite or bipartite (between a workers’ organization and an employer or employers’ organization). Where the social partners have considered it to be in their interest, the dialogue may be extended to NGOs. In the context of a variety of labour relations systems, collective bargaining basically involves negotiations towards binding agreements between employer(s) or their representatives and trade unions; as a process, collective bargaining may be cooperative or adversarial at various points in time. To a greater or lesser extent in each country, the social partners are involved in the governance of the labour market. Furthermore, their influence extends to other types of governance.

¹ GB.286/WP/SDG/3, *Governance, social partnership and globalization: A preliminary review of issues*, Mar. 2003, para. 20.

² *ibid.*, para. 3.

This can sometimes lead to confusion between social dialogue – which involves tripartite/bipartite social partners – and civil dialogue.

3. The earlier document took the term “governance” to mean “the controlling, directing or regulating influence of the set of institutions and policies that determine the functioning of an economy and society”.³ Definitions used by the UNDP, the World Bank and the OECD focus on governance as a process in relation to the exercise of power.⁴ The term “governance” is generally used in two ways, representing different historical experiences and traditions: the first points to a set of societal and institutional features that allow markets to operate optimally; the second to a participatory decision-making process – one in which private actors play an active role alongside public actors.⁵
4. By what measure can governance be described as “good” in the context of globalization? For some, good governance means a wide set of practices that contribute to higher productivity and help to maximize public welfare, with efficiency seen as the desirable outcome.⁶ To this are added the importance of institutions for markets⁷ and the process of public choice.⁸ The “welfare approach” advocates greater equity in income distribution as a measure of good governance. Others see good governance through a gender or environmental lens.
5. Recent thinking brings the different approaches closer together, with participatory policy-making identified as contributing to governance in terms of efficient functioning of markets.⁹ Yet considerable diversity of perspectives remains. The IMF, for instance, has come to differing conclusions about governance in relation to economic performance of labour market and non-labour market institutions in the context of governance.¹⁰ More

³ *ibid.*, para. 3.

⁴ Fukuda-Parr, S. and Ponzio, R.: *Governance: past, present, future. Setting the governance agenda for the Millennium Declaration*, Bergen Seminar Series 2002/2003 (Nov. 2002), <http://www.undp.org/governance/docsaccount/gov-past-present-future.pdf>. See also UNDP: *Reconceptualising governance*, Discussion Paper 2, Management Development and Governance Division, Bureau for Policy and Programme Support, 1998, <http://www.magnet.undp.org/Docs/!UN98-21.PDF/Recon.htm>.

⁵ A third use of the term “governance” relates to public service reform to increase efficiency and responsiveness to citizens’ needs. These reforms often feature privatization, subcontracting and the adoption of private sector management practices as well as anti-corruption measures, etc. Much recent OECD writing on “Public governance and management” falls broadly into this category (see <http://www.oecd.org>). This literature would need to be examined separately in relation to social partnership.

⁶ La Porta, R. et al.: *The quality of government*, NBER Working Paper 6727 (Cambridge, National Bureau of Economic Research, 1998).

⁷ World Bank: *World Development Report 2001/02* (Washington, DC, World Bank, 2002).

⁸ Buchanan, J.: “The constitution of economic policy,” in *American Economic Review* (Nashville, 1987), Vol. 77(3), pp. 243-250; Mueller, D.: *Public Choice II* (Cambridge, Cambridge University Press, 1989).

⁹ Stiglitz, J.E.: *Globalization and its discontents* (London, Allen Lane, 2002).

¹⁰ In chapter 3 of the *World Economic Outlook: Growth and institutions* (Washington, DC, IMF, 2003), indicators of governance applied to non-labour market institutions [including voice and accountability, among other factors] point to the positive role that governance plays in the efficiency

fundamentally, some have suggested that the traditional “good governance agenda” is too narrow, and that a notion of “democratic governance for human development” would be more useful since it encompasses a wider concept of human well-being.¹¹

6. Each of these approaches to governance entails some value judgements as well as the need to be explicit about the costs and benefits. A conception of “good” governance as producing positive outcomes for men and women in terms of efficiency, equity and justice, with recognition of the importance of broad participatory processes in development, would appear to be the most compatible with the operation of social partnership. The quality of institutions that constitute the governance framework for labour markets is central to promoting productivity, growth, sustainable development, employment, rights and poverty eradication.¹² How these institutions (of which social partnership is one type) accommodate competing claims and interests is an important hallmark of governance.

II. Social partnership’s contribution to good governance

1. Social partnership and policy effectiveness

7. At a time of reduced national autonomy and discretion, social dialogue institutions provide national policy-makers with a major tool: information mobilization. This is especially useful when problems are complex, span different policy areas and defy uniform solutions.¹³ In these circumstances, a participatory approach promises to increase policy effectiveness. As just one example, skill development systems that involve those who know skill needs and workforce characteristics, i.e. employers’ associations and trade unions, appear to be more effective than comparable systems in which public actors make all key decisions.¹⁴ Training systems in Brazil and Germany demonstrate this clearly. In Uruguay, as well, social partnership has been instrumental in developing vocational training and competency certification to equip local companies to be more competitive.

sense. In chapter 4, however, it is argued that labour market institutions [which involve, inter alia, voice and accountability] as mirrored in employment protection, union density, bargaining coordination and benefit replacement, are not beneficial for countries in economic terms. The empirical evidence behind these conclusions, however, would suggest more nuanced and in some cases opposite conclusions (see the report’s Appendix 4.1, table 4.3, pp. 146-149).

¹¹ Fukuda-Parr, 2002, op. cit.

¹² ILO: *Working out of poverty*, Report I(A) of the Director-General, International Labour Conference, 91st Session (Geneva, June 2003), p. 68; citing van der Geest, W. and van der Hoeven, R. (eds.): *Adjustment, employment and missing institutions in Africa: The experience in eastern and southern Africa* (Geneva, ILO, 1999) and Rodgers, G. (ed.): *Workers, institutions and economic growth in Asia* (Geneva, ILO, International Institute for Labour Studies, 1994).

¹³ Sabel, C.: “Learning by monitoring: The institutions of economic development,” in Smelser, N. and Swedberg, R. (eds.): *The handbook of economic sociology* (Princeton, Princeton University Press, 1994); and Cohen, J. and Rogers, J. (eds.): *Associations and democracy* (London, Verso, 1995).

¹⁴ Culpepper, P.: *Creating cooperation: How States develop human capital in Europe* (Ithaca, London, Cornell University Press, 2003); CINTERFOR: *La formación profesional y el diálogo social* (Montevideo, CINTERFOR, 2002).

8. The experience of four small countries which used social partnership as one of the means to achieve an economic turn-around – Austria, Denmark, Ireland and the Netherlands – is particularly instructive for policy effectiveness. The social partners of these countries engaged in “concertation,” a process in which they informed each other of their perceptions, intentions and capacities, worked with a common technically sound information base, and clarified and explained their assumptions and expectations. The results were enhanced economic performance, including higher rates of labour market participation for both men and women and reduced unemployment.¹⁵ In the process, the parties realized that they depended on each other to achieve certain policy objectives and to avoid negative trends.¹⁶
9. Social dialogue can also be an important element in industrial policies targeted to particular sectors – especially those in which productivity grows faster than in others. Ireland’s experience in the 1990s exemplifies this. The social partners, sensing a crisis in sectors other than those dominated by successful multinational enterprises, established social partnership structures at the national level that linked wage increases to the least dynamic sectors’ ability to pay. Consequently, multinational enterprises and other fast-growing companies benefited from tremendous gains in competitiveness. Profits rose and, with them, foreign direct investment (FDI) and employment.¹⁷ The recovery has also involved negotiations among government, employers’ organizations, trade unions and some civil society groups that have gone beyond strictly labour market issues to those of greater social inclusion.
10. Denmark tells a different story in terms of the process pursued, but a similarly positive one in terms of results. Unemployment fell from 10.2 per cent in 1990 to 4.7 per cent a decade later. Underpinning this are effective micro and macroeconomic policies that promote competitive adjustment of employment, wage restraint, active labour market policies directed towards flexibility on working hours and other issues such as employability and provision of income security along with extensive social protection. High density of membership in both employers’ and workers’ organizations, and broad coverage by collective agreements have permitted intensive consultations at various levels to facilitate an effective policy mix.¹⁸
11. Another type of social partnership is seen in relation to productivity institutes that are important in many Asian countries, such as in Japan and Singapore. In South Africa, the “Workplace Challenge” launched by the Department of Trade and Industry focuses on productivity of local industry, with the involvement of the social partners.¹⁹ The social partners can also provide early warnings of labour market problems.
12. Local employment pacts and pacts for employment and competitiveness, concluded in various European countries, illustrate how social dialogue can provide for flexibility,

¹⁵ Auer, P. (ed.): *Changing labour markets in Europe: The role of institutions and policies* (Geneva, ILO, 2001).

¹⁶ Visser, J.: “Industrial relations and social dialogue,” in Auer, *ibid.*

¹⁷ Baccaro, L. and Simoni, M.: *The Irish social partnership and the “Celtic Tiger” phenomenon* (Geneva, International Institute for Labour Studies, manuscript, 2002).

¹⁸ Egger, P. et al.: *Decent work in Denmark: Employment, social efficiency and economic security* (Geneva, ILO, 2003).

¹⁹ More examples may be found at <http://www.ilo.org/mcc>.

competitiveness and security within a territorial space below national level.²⁰ The conclusion of such pacts is shaping a new type of governance that brings in a wide variety of public and private actors; this may, however, reflect the weakening of traditional structures. Within the European Union, the web of processes (Luxembourg, Cardiff, Cologne, Lisbon) relating to employment, structural reform and macroeconomic dialogue creates some space for social dialogue that is only now beginning to be explored more extensively.

2. Social partnership and wages, unemployment and related issues

13. A rich literature has investigated the socio-economic correlates of social partnership involving national government and peak associations of employers and workers, particularly as regards inflation and unemployment rates. Some of this literature, mostly on OECD countries, finds that social partnership can – under certain conditions – lead to beneficial macroeconomic outcomes. This appears to be particularly so in relation to wage moderation, to the extent that social partnership brings about wage coordination. Wage coordination is not necessarily coterminous with wage centralization. Even relatively fragmented systems (e.g. Japan or Switzerland) can display a remarkable amount of coordination through other means, e.g. bargaining synchronicity or pattern bargaining.²¹
14. According to a recent World Bank literature review, “countries with coordinated collective bargaining tend, with other factors being equal, to have lower unemployment rates than other countries”.²² Other recent studies also show that the greater the degree of wage coordination, the lower the unemployment rate.²³ However, this factor would clearly not explain the comparatively low unemployment rates of the United Kingdom and the United States, where bargaining is generally decentralized. Coordinated bargaining systems lead

²⁰ Biagi, M.: *Job creation policies at local level and the role of the social partner*, InFocus Programme on Social Dialogue, Labour Law and Labour Administration, Working Paper Series No. 9 (Geneva, ILO, 2002); Geddes, M. and Benington, J. (eds.): *Local partnerships and social exclusion in the European Union: New forms of local social governance* (London, Routledge, 2001).

²¹ Soskice, D.: “Wage determination: The changing role of institutions in the advanced industrialized countries,” in *Oxford Review of Economic Policy* (Oxford, 1990), Vol. 6(4), pp. 36-61.

²² Aidt, T. and Tzannatos, Z.: *Unions and collective bargaining: Economic effects in a global environment* (Washington, DC, World Bank, 2002), pp. 102-103 and table 5-12.

²³ See, for example, Nickell, S.: “Unemployment and labour market rigidities: Europe versus North America,” in *Journal of Economic Perspectives* (Nashville, 1997), Vol. 11(3), pp. 55-74; Baker, D. et al.: *Labor market institutions and unemployment: A critical assessment of the cross-country evidence*, Center for European Studies, Working Paper Series No. 98 (Cambridge, Harvard University, 2002). However, another researcher finds that wage coordination was associated with lower unemployment in the 1980s, but that this effect largely disappeared in the 1990s. Kenworthy, L.: “Corporatism and unemployment in the 1980s and 1990s”, in *American Sociological Review* (Washington, DC, 2002), Vol. 67(3), pp. 367-388.

to superior performance only when the upper echelons have the capacity to make the lower levels comply.²⁴

15. Data in the IMF *World Economic Outlook 2003* (WEO) show a large and statistically significant association between, among other factors, greater unionization and higher unemployment. However, when both trade union density and employment protection are present, they have a strong effect to reduce unemployment.²⁵ Greater coordination of wage bargaining was seen to discourage competitive wage setting, but was found conducive to economy-wide wage moderation. The data suggest that there seems to be an optimal level of wage coordination, after which wage coordination becomes associated with higher unemployment. Thus labour market institutions might be usefully assessed from a perspective of reform measures aimed at strengthening the positive impact on economic performance of institutions that promote the generation of employment, social protection and strengthened capacity of trade unions and employers' organizations. A recent IMF working paper finds that, for all levels of union bargaining strength, wage coordination produces better outcomes than decentralized bargaining outcomes.²⁶
16. Studies also uncover important complementarities between institutions, particularly between monetary and collective bargaining institutions. For example, the data in the IMF 2003 *World Economic Outlook* indicate that the combination of central bank independence and bargaining coordination, not central bank independence alone, reduces unemployment. Similar results have been obtained by other authors.²⁷ Other studies find that labour costs are lower in coordinated/centralized systems.²⁸ Social partnership has also been associated with a more compressed structure of earnings and, therefore, incomes.²⁹

²⁴ Traxler, F. and Kittel, B.: "The bargaining system and performance: A comparison of 18 OECD countries", in *Comparative political studies* (Thousand Oaks, 2000), Vol. 33(9), pp. 1154-1190; Traxler, F.: "Bargaining (de)centralization, macroeconomic performance and control over the employment relationship," in *British Journal of Industrial Relations* (London, 2003), Vol. 41(1), pp. 1-27; and Nickell, S. and Layard, R.: "Labor market institutions and economic performance", in Ashenfelter, O. and Card, D. (eds.): *Handbook of labor economics* (New York, Amsterdam: Elsevier, 1999), Vol. 3C.

²⁵ IMF, 2003, op. cit., table 4.3, p. 147.

²⁶ McHugh, J.: *Wage centralization, union bargaining, and macroeconomic performance*, IMF Working Paper 02/143 (Washington, DC, IMF, 2002).

²⁷ Hall, P.A. and Franzese, R.: "Mixed signals: Central bank independence, coordinated wage bargaining and European Monetary Union", in *International Organization* (Cambridge, 1998), Vol. 52(3), pp. 502-536; Iversen, T.: *Contested economic institutions: The politics of macroeconomics and wage bargaining in advanced democracies* (New York, Cambridge University Press, 1999); Franzese, R.J.: "Institutional and sectoral interactions in monetary policy and wage-price bargaining", in Hall, P.A. and Soskice, D. (eds.): *Varieties of capitalism: The institutional foundations of comparative advantage* (Oxford, Oxford University Press, 2001); Soskice, D. and Iversen, T.: "The non-neutrality of monetary policy with large price or wage setters", in *The Quarterly Journal of Economics* (Cambridge, 2000), Vol. 115(1), pp. 265-284.

²⁸ Kenworthy, 2002, op. cit.; and Traxler, 2003, op. cit.

²⁹ Rueda, D. and Pontusson, J.: "Wage inequality and varieties of capitalism", in *World Politics* (Baltimore, 2000), Vol. 52, pp. 350-383; Wallerstein, M.: "Wage-setting institutions and pay inequality in advanced industrial societies", in *American Journal of Political Science* (Madison, 1999), Vol. 43(3), pp. 649-680; OECD: *Employment Outlook* (Paris, OECD, 1997), p. 77; and Aidt and Tzannatos, 2002, op. cit., p. 103.

17. Analyses focusing on particular institutions or organizational features in isolation (e.g. union density, collective bargaining coverage, employment protection legislation) may fail to assess their total impact, which is often mediated by other institutions. Social partnership can give national policy-makers additional leverage by enabling them to orchestrate a coordinated policy that is beneficial for inflation control, employment and wage distribution. This may involve negotiations over a policy mix that includes wages, working time, various aspects of social protection and other aspects that have direct economic effects.

3. Social partnership, change and crisis

18. The role of social partnership in forging consensus is crucial, especially when policy reforms involve short-term losses in exchange for greater (uncertain) rewards, or internal redistribution among different societal groups. While negotiated reforms may be less extensive than some would advocate, the sense of procedural fairness and ownership that accompanies their adoption greatly bolsters their perceived legitimacy and, hence, their popular acceptance and effective implementation.³⁰
19. Social partnership has the capacity to build societal consensus for controversial, and potentially unpopular, reforms. For example, pension reform in continental Europe has been peacefully adopted when governments involved employers' organizations and, especially, trade unions in its design and implementation.³¹ In Austria, Denmark, Ireland and the Netherlands, labour market reforms launched in the 1990s involved continuous dialogue of the social partners with the government at national and local levels. Those countries illustrate how a set of policy interventions, underpinned by social partnership and commitment to gender equality, can be mixed in ways that enhance their effectiveness.³²
20. During the 1990s, transition countries in Central and Eastern Europe underwent privatization and industrial restructuring that led to declining real wages, mass redundancies and unemployment. Simultaneously, universal social security was overhauled, with differing consequences for men and women workers. While revamped tripartite institutions may have contributed to a smooth process of transition,³³ the weakness of legal and institutional frameworks, social dialogue institutions and the participants in them slowed these countries' capacity to integrate into the market economy.

³⁰ Stiglitz, J.E.: "Participation and development: Perspectives from the comprehensive development paradigm", in *Review of Development Economics* (Oxford, 2002), Vol. 6(2), pp. 163-182; Auer, 2001, op. cit.

³¹ Reynaud, E. (ed.): *Social dialogue and pension reform: United Kingdom, United States, Germany, Japan, Sweden, Italy, Spain* (Geneva, ILO, 2000); Schludi, M.: *The reform of Bismarckian pension systems: A comparison of pension politics in Austria, France, Germany, Italy and Sweden*, unpublished Ph.D. dissertation (Berlin, Humboldt University, 2002); Baccaro, L.: "Negotiating the Italian pension reform with the unions: Lessons from corporatist theory", in *Industrial and Labor Relations Review* (Ithaca, 2002), Vol. 55(3), pp. 413-431.

³² Auer, 2001, op. cit.; Auer, P. (ed): *Employment revival in Europe: Labour market success in Austria, Denmark, Ireland and the Netherlands* (Geneva, ILO, 2000).

³³ Avdagic, S.: *Shaping the paths to labor weakness: The interplay of political strategies and institutional structures in post-communist Central and Eastern Europe*, unpublished Ph.D. thesis (Budapest, Central European University, 2003); and Casale, G. (ed.): *Social dialogue in Central and Eastern Europe* (Budapest, ILO-CEET, 1999).

21. The experience of some developing countries underscores the important role of tripartite social partners in social change. In South Africa, for instance, between the late 1980s and the early 1990s, the country moved from its *apartheid* regime to a burgeoning new democracy and a more open economy. Supported by skilful political management, much of the success of the transition lay in social dialogue institutions at the national level, as now embodied in the National Economic Development and Labour Council and the Millennium Labour Council. The main effect of these and their predecessor institutions was to build trust among the main socio-economic actors based on a reliable, common information base.³⁴ Developments along these lines can be seen in other parts of Africa, particularly in countries participating in ILO technical cooperation projects for strengthening social dialogue.
22. In Mexico, periodically from the mid-1980s through the mid-1990s, social pacts played an important role in addressing the serious economic straits faced by the country. Through intensive and often difficult dialogue, the social partners contributed to bringing inflation under control, aligning wage increases to productivity and providing rapid economic stability. In the mid-1980s in Uruguay and in the early 1990s in Chile, social dialogue kick-started the restoration of democratic rule and economic reform.
23. The role of social partnership in responding to financial crises has been shown in Asia as well.³⁵ For example, in the Republic of Korea, the Government, the two major trade union federations and the employers' organizations overcame many of their differences to sign a social pact in 1998. The pact aimed at reforming the national economy while minimizing the negative social consequences of the Asian financial crisis, and is thought to have contributed to speedier economic recovery.³⁶

4. Social partnership at the enterprise level

24. Enterprises themselves define their own success not merely in terms of profits, but more broadly to take into account relationships with their shareholders, employees and their representatives, subcontractors, as well as stakeholders such as consumers and community groups. Firms and trade union organizations can engage in social partnership in a way that brings in all of the units of a firm within a country, subregion or (as, for example, in the few international framework agreements concluded to date) the world.³⁷ Within the firm, social partnership can encompass various forms of non-adversarial labour-management initiatives, even extending in a few countries to co-determination on a range of issues.

³⁴ Adler, G. and Webster, E. (eds.): *Trade unions and democratization in South Africa, 1985-1997* (London, Macmillan, 2000); and Deegan, H.: *The politics of the new South Africa: Apartheid and after* (Harlow and New York, Longman, 2001).

³⁵ Campbell, D.: "Social dialogue and labor market adjustments in East Asia after the crisis", in Betcherman, G. and Islam, R. (eds.): *East Asian labor markets and the economic crisis: Impacts, responses, and lessons* (Washington, DC, World Bank and ILO, 2001).

³⁶ See Lim, S-H.: *Strategy matters: A constructivist approach to the South Korean social pact*, unpublished Ph.D. dissertation (Madison, University of Wisconsin, Industrial Relations Research Institute, 2002); Sun Hak Tae: *The political economy of democratic consolidation: Dynamic labour politics in South Korea* (Kwangju, Chonnam National University Press, 2002)

³⁷ Anonymous: "Update on global agreements", in *European Industrial Relations Review* (London, 2003), No. 353, pp. 26-30; IUF/COLSIBA and Chiquita agreement on freedom of association, minimum labour standards and employment in Latin American banana operations (14 June 2001).

25. The literature examining collective bargaining at the enterprise level sees trade unions pushing wage costs above their market-clearing level, but compensating for higher wage costs (in some cases) by increasing productivity.³⁸ Trade unions encourage investments in the workforce and mobilize workers' tacit knowledge to tackle workplace problems and bottlenecks. This contribution to efficiency implicitly underlies collective agreements concluded on employment and competitiveness.³⁹ While sometimes criticized for rigidity, collective bargaining can create space for finding creative cooperative solutions.⁴⁰
26. In high performance workplaces, new forms of work organization, such as teamwork, job rotation, contingent pay, flatter hierarchies, etc. lead to greater productivity and profitability when they are adopted in bundles, rather than as single pieces.⁴¹ Social partnership can pave the way for using such bundles effectively. A recent study has found a significant productivity advantage for firms with works councils relative to those without them.⁴² However, various forms of social partnership are certainly not the only way to achieve high performance enterprises.⁴³
27. Finally, social partnership at the enterprise level in multinationals is guided by two long-standing international governance instruments: the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy adopted within the ILO (1977, amended 2000),⁴⁴ and the OECD Guidelines for Multinational Enterprises (1976, amended 2000). These two declarations, along with another type of initiative, the Global Compact, include two of the fundamental preconditions for social partnership – freedom of association and effective recognition of the right to collective bargaining – in the list of principles which companies embrace upon signing up. A further aspect of governance at the enterprise level is the role played by codes of conduct and social accountability initiatives⁴⁵ – only some of which, however, involve social partnership.

³⁸ Freeman, R.B. and Medoff, J.L.: *What do unions do?* (New York, Basic Books, 1984); Aidt and Tzannatos, 2002, op. cit.

³⁹ For examples of such agreements, see: Zagelmeyer, S.: *Innovative agreements on employment and competitiveness in the European Union and Norway* (Luxembourg, the European Foundation for the Improvement of Living and Working Conditions, 2000).

⁴⁰ Ozaki, M. (ed.): *Negotiating flexibility: The role of the social partners and the state* (Geneva, ILO, 1999).

⁴¹ Appelbaum, E. and Batt, R.: *The new American workplace: Transforming work systems in the United States* (Ithaca, ILR Press, 1994); Kochan, T. and Osterman, P.: *The mutual gains enterprise: Forging a winning partnership among labor, management, and government* (Boston, Harvard Business School Press, 1994); Ichniowski, C. et al: "What works at work: Overview and assessment", in *Industrial Relations* (Berkeley, 1996), Vol. 35(3), pp. 299-333.

⁴² Zwick, T.: *Works councils and the productivity impact of direct employee participation*, discussion paper, No. 03-47 (Mannheim, Zentrum für Europäische Wirtschaftsforschung, 2003).

⁴³ For a variety of approaches, see Ashton, D. and Sung, J.: *Supporting workplace learning for high performance working* (Geneva, ILO, 2002) and Tolentino, A: *Labour-management cooperation for productivity and competitiveness*, Management and Corporate Citizenship Programme, Working Paper (Geneva, ILO, 2000).

⁴⁴ Snapshots of social partnership appear in ILO: *A guide to the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy* (Geneva, ILO, 2002), pp. 9-18.

⁴⁵ See GB.288/WP/SDG/1 (Nov. 2003).

5. Social partnership and improved corporate governance

28. In the wake of financial scandals involving major global companies, there has been a clamour to reform the rules applicable to corporate governance (taken to mean the rules governing the management of corporations and their interaction with others such as shareholders, accountants, financial institutions, stock exchanges, etc.). Proposals to enhance transparency, avoid conflicts of interest, improve accounting practices, avoid insider trading, reduce excessive managerial compensation spread, and monitor corporate behaviour are coming from within the corporate world and outside it. While there is considerable literature on various arrangements for social partnership involving the operation of enterprises at various levels (e.g. information and consultation, collective bargaining, codetermination and representation of trade union leaders on corporate boards), it does not systematically examine how social partnership relates to the quality of corporate governance as such.
29. Perhaps opportunities for malfeasance are lower when managers are not simply accountable to shareholders, but also to organizations representing workers and other stakeholders. The extent to which “whistleblowers” are protected from retaliation could also have an indirect effect on corporate behaviour. Such hypotheses along with others may deserve testing.

6. Challenges ahead for social partnership and good governance

30. In the context of globalization, social partnership is a flexible tool that enhances participation and transparency. It can increase information and options for both supply-side and demand-side policies, to weather cyclical downturns as well as to manage upturns. Under certain circumstances, it can also enhance competitive strategies for firms.
31. Why, then, are the advantages of social partnership not universally recognized by policy-makers? Some choose to focus only on what they perceive as the negative impact rather than the positive contribution of the social partners. In addition, not all forms of social partnerships work to their full potential. In many cases, the conditions for social partnership to flourish are simply not in place. Where freedom of association and collective bargaining rights are denied, there can be no social partnership. Even when these are respected, excessive organizational fragmentation and sometimes rivalry among both trade unions and employer associations hinders inter and intra-organizational coordination.⁴⁶
32. Employers’ and workers’ organizations are more likely to ensure compliance with negotiated policies through broad discussion of issues at various levels of their organizations, followed by fair and transparent decision-making procedures.⁴⁷ Group interests and general interests can be reconciled through organization of as many of their potential constituents as possible, or at least through internal representation of the diversity

⁴⁶ Baccaro, L.: “What is alive and what is dead in the theory of corporatism”, in *British Journal of Industrial Relations* (London, 2003), Vol. 41(4), pp. 683-706.

⁴⁷ *ibid.*

of interests and groups in society.⁴⁸ The shrinking membership of many employers' and especially workers' organizations is in itself a threat to social partnership.

33. The different interests of employers and workers can result in a culture of conflict that prevents their representatives from seizing opportunities for mutual benefit. Inappropriate dispute resolution systems may not be geared to supporting the social partnership process. Organized actors may lack capacity, information and expertise to engage constructively with their counterparts. This can invite hijacking of social dialogue by governments, which in turn weakens the social partners in the eyes of their membership. In addition, while there is a well-accepted way to measure breakdowns in labour relations (strikes and lockouts), additional indicators that would make it easier to empirically demonstrate the effectiveness of social partnership are still being tested.
34. A further challenge to organizations that are ready to engage in social partnership is increasing informality – itself principally a governance issue.⁴⁹ Governments could do much to fix inappropriate or malfunctioning legal and institutional frameworks that encourage informality and deny a voice to large groups of society. For employers' and workers' organizations, outreach is key. Alliances with NGOs are one way for employers' and workers' organizations to do this; expansion into the informal economy is another. Increasing women's membership and influence reinforces the legitimacy and strength of democratic, representative organizations as governance agents in the labour market. Globalization trends suggest that such outreach could be critical to optimizing social partnership as a useful governance tool.
35. While social partnership faces challenges, it is within the reach of employers' and workers' organizations to overcome them by seeking solutions that work best in the governance context of each country. By ensuring freedom of association and respect for the right to engage in collective bargaining, governments can enable these organizations to realize the potential of social partnership as part of good governance.

III. A look at some elements of good governance

1. Preliminary comments

36. After reviewing key elements of good governance,⁵⁰ the document examined earlier by the Working Party listed a number of characteristics of good governance: respect of individual

⁴⁸ Olson, M.: *The logic of collective action: Public goods and the theory of groups* (Cambridge, Harvard University Press, 1965).

⁴⁹ See "Conclusions concerning decent work and the informal economy", International Labour Conference, 90th Session, June 2002, *Provisional Record*, No. 25.

⁵⁰ These were respect for fundamental rights, the rule of law and clean, transparent and accountable government; an effective system of property rights and contract enforcement; the regulation of markets to curb fraud and anti-competitive behaviour and to promote sound corporate governance; fiscal and monetary institutions that ensure economic stability; institutions to provide social protection and manage social conflict; and an adequate level of social capital and trust for economic transactions (GB.286/WP/SDG/3 (Mar. 2003), para. 11, citing Rodrik, D.: *Institutions for high-quality growth: What are they and how to acquire them*, paper delivered at the IMF Conference on Second Generation Reforms, November 1999.

rights and democratic processes; the legitimacy, accountability and transparency of government action; the size of the State and the extent of regulation of the economy; greater openness to international trade; the degree of competitiveness of markets; the quality of the judicial system; whether certain institutions such as insurance, bankruptcy procedures or intellectual property rights are missing; and the adequacy or inadequacy of informal institutions.⁵¹

37. A literature review on these topics reveals unevenness in terms of the extent and the quality of research done in a variety of disciplines. The literature is far too vast to treat adequately here, and the questions of the extent of regulation of the economy and other more specific aspects would need to be dealt with in future documents.
38. While terms such as “determinants” and “characteristics” are used in relation to good governance, the literature tends to focus on testing possible correlations between various components of governance and economic performance, with considerable debate about methodologies and causality.
39. Probably the largest attempt to monitor the state of good governance in almost all countries has been undertaken in a series of studies using World Bank data.⁵² Aggregation of a large number of qualitative and quantitative indicators into clusters led to the identification of these groups of indicators of outcomes: voice (referring explicitly to trade unions and implicitly to employers’ organizations) and accountability; political instability and violence; government effectiveness; regulatory burden; rule of law; and graft (fight against corruption). The empirical evidence is now leading to a rethinking of the relative importance of these and other factors.⁵³ Recent World Bank research has suggested probing more deeply into the public-private governance nexus and the empowerment of non-traditional stakeholders. This has obvious relevance to social partnership.
40. The role of social capital has been highlighted in explaining economic outcomes, with institutions and incentives seen as key factors in economic activities.⁵⁴ Moreover, “the absence of an appropriate framework for the governance of markets in general, and labour markets in particular, creates an environment of insecurity which prevents the accumulation of physical, financial, human and social capital”.⁵⁵

⁵¹ GB.286/WP/SDG/3 (Mar. 2003), para. 12.

⁵² The work of Kaufmann and colleagues may be consulted at <http://www.worldbank.org/wbi/governance>.

⁵³ Kaufmann, D.: *Rethinking governance: Empirical lessons challenge orthodoxy*, discussion draft (Washington, DC, World Bank, 2003).

⁵⁴ See Tirole, J.: *The theory of industrial organization* (Cambridge, MIT Press, 1989); Laffont, J. and Tirole, J.: *A theory of incentives in procurement and regulation* (Cambridge, MIT Press, 1993); North, D.: *Institutions, institutional change and economic performance* (Cambridge, Cambridge University Press, 1990).

⁵⁵ ILO, 2003, op. cit., p. 72.

2. A closer look at some elements of good governance and their relation to economic variables

(a) *Democracy, political stability and size of government*

41. Although democracy is an end in itself, it has been specially studied in relation to governance as expressed in economic performance.⁵⁶ Some research finds that democracy would tend to slow growth rates, while more authoritarian regimes would foster them.⁵⁷ Other studies see positive correlations between democracy and growth,⁵⁸ and find that dictatorships tend to be inefficient.⁵⁹ However, another strand of thinking argues that there is no clear link either way between democracy and growth.⁶⁰
42. One explanation for the divergent results may be the lack of homogeneity of both democratic and authoritarian regimes. A “technocratic” regime and a “kleptocratic” one perform quite differently in terms of economic outcomes. Comparative institutional analysis based on case studies reveals that if any regime (democratic or authoritarian) can acquire a certain degree of insulation from pressures and lobbyists, by using merit-based methods of recruitment for its civil service, ensuring institutional independence for the justice system, and some degree of flexibility in terms of dealing with technological innovations and market conditions, it would lead to more efficient outcomes.⁶¹ There is also apparently a connection between democracy and better handling of adverse shocks, greater short-term stability and avoiding disasters such as famines.⁶²
43. It is widely accepted that political stability is deeply connected with economic growth.⁶³ Risk-averse economic agents flee or hesitate to enter uncertain situations. A relationship exists between political instability and lower rates of growth, higher inflation and lower external borrowing. The key aspect relating democracy with efficiency, from the economic point of view, appears to be the predictability of outcomes rather than accountability

⁵⁶ Bardhan, P.: *Democracy and development: A complex relationship*, draft (Berkeley, University of California, 1997).

⁵⁷ e.g. Alesina, A. et al.: *Political instability and economic growth*, NBER Working Paper 4173 (Cambridge, National Bureau of Economic Research, 1992).

⁵⁸ e.g. Barro, R.: “Economic growth in a cross section of countries”, in *The Quarterly Journal of Economics*, Vol. 106(2), pp. 407-443 (Cambridge, 1991); and Barro, R.: *Democracy and growth*, NBER Working Paper 409 (Cambridge, National Bureau of Economic Research, 1994); Drèze, J. and Sen, A.: *Hunger and public action* (Oxford, Oxford Clarendon Press, 1989); and Rodrik, 1999, op. cit.

⁵⁹ Bardhan, P.: “Symposium on the State and economic development”, in *Journal of Economic Perspectives* (Nashville, 1990), Vol. 4(3), pp. 3-7.

⁶⁰ e.g. Przeworski, A. and Limongi, F.: “Political regimes and economic growth”, in *Journal of Economic Perspectives* (Nashville, 1993), Vol. 7(3), pp. 51-69.

⁶¹ *ibid.*

⁶² Rodrik, 1999, op. cit.; Drèze and Sen, 1989, op. cit.

⁶³ For instance, in Alesina et al., 1992, op. cit.

per se.⁶⁴ As seen in Part II, employers' and workers' organizations can face crises together and act as a force for social and political stability.⁶⁵

44. As for government size and its linkages with good governance, recent empirical work has found that better-functioning governments collect more taxes and are more accountable and responsive to public needs.⁶⁶ A study of 60 countries over the last four decades found that the average size of the government in terms of percentage of GDP grew by about 8 percentage points from the 1960s to the 1990s.⁶⁷ While the size of government is associated negatively to growth, an increase in government expenditures can have a proactive effect.⁶⁸ How taxes are collected and spent is of keen interest to both employers' organizations and trade unions. Thus, they are among those involved in public participation in budget preparation, as pioneered in some Brazilian local governments, and in gender budgeting, which is now in use in around 40 countries.⁶⁹

(b) Rights, the judicial system and good governance

45. Evidence supports the view that the extent of respect for certain human rights (in particular freedoms of the press, opinion, assembly and association, and the right to a fair trial under rule of law) is important for positive economic outcomes in many countries.⁷⁰ A recent study of Latin American countries showed that those with stronger civic rights tended to have higher shares of formal employment and lower shares of informal employment.⁷¹ Rights at work have been seen as going hand in hand with economic benefits.⁷²

⁶⁴ Bardhan, 1997, op. cit.

⁶⁵ See also Date-Bah, E. (ed.): *Jobs after war: A critical challenge in the peace and reconstruction puzzle* (Geneva, ILO, 2003), available at <http://www.ilo.org/public/english/employment/recon/crisis>.

⁶⁶ Dreyer-Lassen, D.: *Political accountability and the size of government: Theory and cross-country evidence*, EPRU Working Paper Series, Economic Policy Research Unit (Copenhagen, University of Copenhagen, 2000); La Porta et al., 1998, op. cit.

⁶⁷ Persson, T.: *Do political institutions shape economic policy?* NBER Working Paper No. 8214 (Cambridge, National Bureau of Economic Research, 2001).

⁶⁸ Ram, R.: "Government size and economic growth: A new framework and some evidence from cross-section and time series data", in *American Economic Review* (Nashville, 1986), Vol. 76(1), pp. 191-203.

⁶⁹ UNDP: *Human Development Report 2002: Deepening democracy in a fragmented world* (New York, UNDP), p. 81.

⁷⁰ Sen, A.: "Work and rights", in *International Labour Review* (Geneva, 2000), Vol. 139(2), pp. 119-128. See also UNDP: *Human Development Report 2000: Human rights and human development* (New York, UNDP); and Isham, J., Kaufmann, D. and Pritchett, L.: "Civil liberties, democracy, and the performance of government projects", in *The World Bank Economic Review* (Washington, DC, 1997), Vol. 11(2), pp. 219-242.

⁷¹ Galli, R. and Kucera, D.: *Informal employment in Latin America: Movements over business cycles and the effects of worker rights*, Discussion Paper DP/145/2003 (Geneva, International Institute of Labour Studies, 2003).

⁷² Sengenberger, W.: *Globalization and social progress: The role and impact of international labour standards* (Bonn, Friedrich Ebert Stiftung, 2002).

46. Secure and stable property rights are often highlighted as means of achieving economic growth, since it is through them that an investor would accumulate and introduce innovation basic to economic growth.⁷³ The primary guarantees of this are property and commercial law, particularly the law of contracts; however, these are areas in which people active in the informal economy and – in some societies, women – encounter difficulties. In addition, some studies have pointed out that even countries with a relatively weak legal system can show very good economic performance.⁷⁴
47. The judicial system is regarded as a major actor in good governance, both as a primary vehicle for upholding the rule of law, and as part of government administration. An unpredictable, inefficient or corrupt judiciary is a major obstacle to good governance.⁷⁵ Low cost, efficient, accessible legal systems are regarded as a key factor in upholding the rule of law, ensuring political and property rights and avoiding corruption or abuses.⁷⁶ However, recent literature suggests placing greater emphasis on informal as well as formal institutions such as courts.⁷⁷

(c) **Trade and good governance**

48. In relation to governance, the degree of openness in trade is seen as a very significant determinant of economic growth, although it shows mixed consequences for income distribution and levels of poverty.⁷⁸ Increasing competition in markets due to openness in trade lowers what can be extracted by rent-seeking behaviour.⁷⁹ Elimination of import

⁷³ Rodrik, 1999, op. cit.

⁷⁴ Posner, R.: “Creating a legal framework for economic development”, in *The World Bank Research Observer* (Washington, DC, 1998), Vol. 13(1), pp. 1-11.

⁷⁵ Messick, R.: “Judicial reform and economic development: A survey of the issues”, in *The World Bank Research Observer* (Washington, 1999), Vol. 14(1), pp. 117-136.

⁷⁶ North, 1990, op. cit.

⁷⁷ e.g. Hewko, J.: *Foreign direct investment: Does the rule of law matter?* Rule of Law Series, Working Paper No. 26 (Washington, Carnegie Endowment for International Peace, Apr. 2002); Upham, F.: *Mythmaking in the rule of law orthodoxy*, Rule of Law Series, Working Paper No. 30 (Washington, Carnegie Endowment for International Peace, Sep. 2002).

⁷⁸ The liberalization process in Latin American countries has been analysed extensively. UNDP-ECLAC and Ganuza, E. (ed.): *Liberalización, desigualdad y pobreza: América Latina y el Caribe en los 90*; Buenos Aires: Eudeba, UNDP, ECLAC, 2001); Morley, S.: *Poverty during recovery and reform in Latin America: 1985-1995*, draft (Washington, DC, Inter-American Development Bank, 1997). It is argued that there exists “little persuasive evidence concerning the effect of trade on income or on how causality is operating”. Frankel, J. and Romer, D.: “Does trade cause growth?” in *American Economic Review* (Nashville, 1999), Vol. 89(3), pp. 379-399.

⁷⁹ However, differentiation in imports and exports is another element to take into account. The term “rent seeking” refers to a form of economic behaviour that aims at avoiding competitive or market pressure in order to bring about price distortions in one's own interest in the political sphere. “Rent” is essentially income that is not matched by corresponding labour or investment in the market sense. Rent in this sense arises from manipulation of the economic environment (e.g. monopolies, import and trading restrictions, subsidies, etc.). See Krueger, A.: “The political economy of the rent-seeking society”, in *American Economic Review* (Nashville, 1974), Vol. 64(3), pp. 291-303; Ades, A. and Di Tella, R.: “Rents, competition and corruption”, in *American Economic Review* (Nashville, 1999), Vol. 89(4), pp. 982-993.

quotas can also lead to reduction in smuggling, bribery and black markets. Lower sector concentration in exports and proximity to main world markets have also been correlated to lower corruption and stronger accountability, among other factors.⁸⁰

49. Although lowering tariffs may cause reductions in corruption and rent-seeking behaviour, openness needs to be accompanied by enhancing institutional capability. Other development policies such as investment in infrastructure, human capital, health and social protection are suggested as possibly more useful to hinder corruption.⁸¹ In addition, the opening of markets poses both challenges and opportunities for social partnership. Since countries that trade tend to have larger and better-functioning governments, one explanation offered is that they tend to compensate for the high risk of exposure in global markets by trying to protect their citizens through safety nets or public employment and by investment in institutional strengthening and capacity building.⁸²
50. In 1996, an OECD study essentially concluded that there was no evidence linking trade competitiveness and non-respect for freedom of association.⁸³ A recent cross-country study has found fairly robust results that stronger freedom of association and collective bargaining rights are associated with higher total manufacturing exports (a result probably explained by the many countries having at once weak rights and little integration into global markets).⁸⁴ The authors argue that possible negative effects through wages of stronger rights and democracy may be offset by other positive effects, such as greater economic and social stability, which in turn facilitates export competitiveness.
51. There is wide recognition that trade, along with capital inflows and migration, affects a country's previous endowments (natural and human resources), and also its productivity, through the adoption of innovative technology from abroad. A country will invest in, and attract investment in, human capital, technology and research in so far as it boasts quality institutions, accountability, transparency and low levels of corruption. The recently issued *World Trade Report* emphasizes the importance of openness in improving efficiency and stimulating growth.⁸⁵

(d) Accountability, transparency and institutions

52. The threads that bring together literature on such different issues as democracy and trade are accountability, transparency and the quality of institutions. Accountability and transparency have been recently studied in many countries, finding a strong efficiency link,

⁸⁰ Bonaglia, F., Braga de Macedo, J. and Busollo, M.: *How globalisation improves governance*, OECD Development Centre, Technical Paper No. 181 (Paris, OECD, 2001).

⁸¹ Larrain, F. and Tavares, J.: *Can openness deter corruption?* LACEA Conference, draft (Rio de Janeiro, LACEA and Harvard University, 2000).

⁸² Rodrik, D.: "Why do more open economies have bigger governments?", in *Journal of Political Economy* (Chicago, 1998), Vol. 106(5), pp. 997-1032.

⁸³ OECD: *Trade, employment and labour standards: A study of core workers' rights and international trade* (Paris, OECD, 1996).

⁸⁴ Kucera, D. and Sarna, R.: *International trade and freedom of association and collective bargaining rights: A bilateral gravity model approach*, draft (Geneva, International Institute for Labour Studies, Sep. 2003).

⁸⁵ WTO: *World Trade Report* (Geneva, 2003), pp. 89-100.

which may be particularly pronounced in a local context.⁸⁶ The overview of social partnership in Part II illustrated how strong institutions of social partnership can contribute to successful socio-economic policies through information, coordination and consensus-building.

53. Malfunctioning institutions can be regarded as a significant factor hindering good governance of governments, companies and other institutions. Corruption, a major type of malfunctioning, is curbed where secure democratic institutions, high accountability and low monopoly power are present. This is why many view open trade and competitive markets as a way of raising the costs and reducing the benefits of corruption, thus fostering better governance.
54. Corruption is a crucial factor hindering investment, entrepreneurship, innovation and even the introduction of technological advances.⁸⁷ It also impedes achieving respect for rights. Democratic systems, parliamentary checks-and-balances, political stability and media freedom are regarded as key elements to curb corruption.⁸⁸ Vulnerability to corruption is also important to consider, as where there are low salaries in the public sector.
55. Most of the studies on transparency and accountability focus on processes within government, plus the existence of a free press. Recent writing on governance has called for a sharper focus on external accountability.⁸⁹ This suggests the usefulness of looking more closely into the role that groups such as employers' organizations and trade unions play in pushing for accountability and transparency of government.⁹⁰ This may also entail examining the accountability and transparency of these organizations, many of which – unlike most NGOs – are subject to legal reporting requirements. Lack of transparency in NGOs about their membership, funding and accountability is a major reason why employers' and workers' organizations are ill at ease with being referred to in the same category. The collective agreements they conclude are often publicly available, and the bargaining process itself makes the issues addressed and the solutions reached more transparent for the general public.

3. Possible next steps for the Working Party

56. The literature review on governance brought to light several other possibly important elements. Some were already identified in the Working Party – the extent of regulation of the economy in various fields, per capita income and its distribution, missing institutions in areas such as bankruptcy, insurance and intellectual property (to which could be added

⁸⁶ Kaufmann, D., Kraay, A. and Mastruzzi, M.: *Governance matters III: Governance indicators for 1996-2002* (Washington, DC, World Bank Institute, 2003), available at <http://www.worldbank.org/wbi/governance>; Wade, R.: *Governing the market* (Princeton, Princeton University Press, 1990).

⁸⁷ Mauro, P.: "Corruption and growth," in *The Quarterly Journal of Economics* (Cambridge, 1995), Vol. 110(3), pp. 681-712; Krueger, 1974, op. cit.; North, 1990, op. cit.

⁸⁸ Laporta et al., 1998, op. cit.

⁸⁹ Kaufmann, 2003, op. cit.

⁹⁰ Fukuda-Parr and Ponzio, 2002, op. cit., p. 9, cite an initiative involving participatory preparation and monitoring of budget processes in areas of India that started with the discovery that workers were being paid far less than the amount local authorities billed to the State and central governments. See also UNDP: *Human Development Report 2002*, op. cit.

social dialogue), and the adequacy or inadequacy of informal institutions. Other topics newly reflected in the literature include the growing importance of external accountability, the private-public governance nexus, decentralization, governance aspects of financing for development, gender, ethnicity, and technology. All appear worthy of examination in the context of governance and social partnership.

- 57.** While some of the elements of good governance reflect basic problems of development, others are much more a question of political will and policy choice. Social partnership can play a key role in ensuring that the policy choices made serve the ends as well as the means of participatory governance. Putting in place the conditions that permit the potential of social partnership to be realized is part and parcel of good governance. Civil liberties and rights, such as freedom of association and the right to engage in collective bargaining, enable the social partners to exist, to participate in governing the labour market and to contribute to the achievement of economic and social goals.
- 58.** Other conditions are openness to engaging with the world economy and the rule of law as reflected in effective and non-corrupt administrations. Related to this is a well-functioning, efficient system of relevant, gender-sensitive laws for all parts of the economy, and impartial judicial enforcement. When government does its part to create the necessary framework to permit them to carry out their roles, the social partners themselves have an opportunity to demonstrate to an even greater extent how social partnership is contributing to what can truly be seen as good governance.

Geneva, 15 October 2003.