Pathfinder Economic Flash

Balancing the short Term Vs. Long term Interest of Workers

Proposals for minimum wages, unemployment benefit, pension for private sector, medical insurance…

There were recent press reports that a number of trade unions have submitted proposals to the National Pay Commission requesting establishment of; 1. a National Wages Commission for the private sector; 2. a national minimum wage; 3. an unemployment benefit insurance scheme; 4. a pension scheme for EPF members. In addition, a medical insurance and social security scheme for the informal sector employees has also been proposed.

These are important proposals with far reaching consequences that require careful consideration as well as frank and open discussions among all stake-holders. Any civilized society should attach high priority to the welfare of workers as well. This can best be achieved by generating decent employment opportunities that provide secure and gainful livelihoods not only for the present day workers but also for future generations. The countries which have experienced sustainable, high paying jobs have realized this only through the creation of an environment conducive for attracting large foreign and local investments. Taking short-cuts through populist policies will inevitably undermine macroeconomic stability and competitiveness thereby destroying jobs, fueling inflation and exerting pressure on the balance of payments/reserves. We have seen examples of the consequences of uncompetitive and unaffordable social welfare systems in the crises experienced by European countries such as Greece and Spain in recent times. Youth unemployment in these countries soared to over 50% due to the failure of short-sighted so-called pro labour populist policies.

Why is there no mention of productivity? We cannot eat fruits before tree is gone

It is important to recognize that these proposals to improve the welfare of workers need to be linked to increases in productivity (i.e. the amount of goods or services produced by a worker) and competitiveness. This is particularly important in a country where productivity is extremely low by the standards of a number of our Asian competitors. Furthermore, a lack of competitiveness has been at the heart of Sri Lanka's socioeconomic indicators declining from being second in Asia at independence, and ahead of South Korea and Singapore as late as the early 1960's, to a point where they are well behind those of several East and Southeast Asian countries today. It is interesting that the successful Asian countries have not gone down the path of such populist policies. It is prudent to hark back to a comment made by Professor Joan Robinson (a left-oriented Keynesian economist from Cambridge University) in the late 1950's. She stated that Sri Lanka had eaten the fruits before the tree had grown.

One cannot get away from affordability: who is going to pay?

Government Contributions

It is, therefore, important to anchor these proposals firmly to productivity/competitiveness improvements. A failure to do so implies that the government and employers would have to play a major role in funding these benefits. It is useful to explore the feasibility of doing this. First, the government has attached high priority to fiscal consolidation. The Pathfinder Foundation (PF) has repeated ad nauseam that the budget has been the major source of instability in the system. It is highly commendable, therefore, that the government is making progress in fiscal consolidation. It is important not to undermine this process. Now that Sri Lanka is a low-middle-income country, a failure to maintain fiscal discipline will inevitably result in a downgrading by rating agencies and a financial crisis. Failure to keep this process of fiscal consolidation on track will result in deterioration in the county's debt dynamics and an eventual slide to a Greece-style crisis which will inevitably have a devastating impact on the lives of working people. Experience from around the world has demonstrated very vividly that it is the poor, the vulnerable and ordinary working people who bear the brunt of the extremely painful fallout from such economic crises. In short, the trade unions and populist politicians, who promote eating fruits before trees are grown, merely create miserable conditions for workers, employers as well as politicians themselves.

Another question that needs to be raised is what would be the opportunity costs of allocating large sums of public money to fund such social welfare schemes. Cuts in infrastructure investment as well as expenditure on health, education and subsidies/transfers would be necessary. Public expenditure on health and education is already under pressure. Despite the much-needed large scale infrastructure development that is being achieved in recent years, Sri Lanka's infrastructure spending as a percentage of GDP is still less than that of a number of its competitors in East and Southeast Asia. The bottom line is that the opportunity costs of large-scale government funding of the worker welfare measures proposed by the trade unions would be prohibitive.

Employers' contribution

One also needs to consider the implications of employers being called upon to make significant contributions to fund these ambitious schemes. The lacklustre investment performance, both domestic and foreign, has arguably been the most disappointing aspect of the post-conflict scenario. It is concerning that private sector credit growth is muted and cash-rich corporates are holding back on investment. It is commendable, therefore, that the authorities have attached priority to strengthening the macroeconomic framework, particularly through fiscal consolidation, and improving Sri Lanka's ranking on the World Bank's Doing Business Index. These are still a work-in-progress. In addition, more needs to be done to improve the predictability and consistency of policies and to implement structural reforms, including greater flexibility in labour markets.

Imposing further costs on employers would not be in the broader interests of workers at a time when attracting investment is the highest priority of Sri Lankan policy makers. Such costs would act as a deterrent to investment in an already under-performing context. This would, in turn, not only destroy employment opportunities but also discourage the upgrading of technology and innovation necessary to create higher value (better paying) employment. Another negative effect would be the incentivizing of an increased recourse to temporary and casual employment to avoid the incremental costs to employers associated with funding these welfare proposals. This would result in lower overall labour standards. One may conclude that adding an additional layer of employment costs to fund these proposals, without any linkage to productivity/competitiveness, would result in destruction of potential new jobs; stifling of an upgrading of existing employment; and lowering of overall labour standards.

Workers' Contributions

The foregoing has sought to argue that the scope for government and employer funding for such schemes is likely to be constrained in the context of Sri Lanka's current level of development. The final part of the narrative relates to worker contributions. Here again, there are affordability issues. In the current low productivity/low wage scenario, the capacity of workers, particularly those who most need such support, to contribute to such schemes would be very limited. The question which needs to be asked is: can workers afford to bear a meaningful share of the costs of the proposed schemes in a context where there is very limited fiscal space for the government and where adding further costs onto employers would have significant negative effects on the prospects of workers?

A national minimum wage

The proposal for a national minimum wage needs separate treatment. The question that needs to be asked is whether a country, which continues to face major challenges in terms of productivity/competitiveness, can afford a national minimum wage. Here again, a debate needs to be had whether the way forward is to have a national minimum wage or a series of productivity-linked wage agreements at the enterprise or sector levels. A public sector institutional arrangement, at the national level, could play a role in facilitating these agreements and addressing cases of evidenced-based injustices. Any government or trade union action to artificially increase wages of workers will harm the investor confidence and international competitiveness of exports which are the lifeblood of the Sri Lanka economy which is a small island nation with a limited market.

Pursuing the real interests of workers: both current and future job-seekers

It is in the interest of the workers of this country to create the conditions for generating higher value employment so that they can enjoy a steady improvement in the living standards of their families. There are serious questions that need to be addressed regarding the affordability of the proposals submitted by some very important trade unions to the National Pay Commission. It is clear that any consideration of such schemes cannot be divorced from a hard-headed approach to the low productivity / competitiveness problem confronting Sri Lanka. It would not be in the interests of the workers to implement programs which would undermine fiscal discipline and create macroeconomic instability (inflation and balance of payments/foreign reserves pressure) that would have very painful consequences for the workers. Nor is it in the interest of workers to pursue schemes that destroy potential jobs, deter the upgrading (higher wages) of existing employment and result in lower overall labour standards.

It is an immutable fact that the social protection schemes proposed by these important unions can only become feasible, if there is a significant improvement in productivity/competitiveness. This would increase both profitability and wages thereby increasing the capacity of employers and workers to contribute to funding such schemes. The resulting higher levels of economic activity would also boost government revenue, thereby increasing the fiscal space to support such programs.

A well-structured unemployment benefit/training scheme would create conditions, which are more conducive to introduce the much-needed reforms to increase labour market flexibility, by providing necessary support for workers in a modernizing economy. However, the introduction of such a scheme should be part of a wider discussion and norm-setting on productivity/competitiveness.

The trade unions have raised issues which need careful consideration in a modernizing economy. In PF’s view, their case would be much stronger, if they made it clear that they attach the highest priority to working with businesses and the government to improve productivity/competitiveness.

This is the Forty Fifth Economic Flash published by the Pathfinder Foundation (PF). Readers' comments are welcome at www.pathfinderfoundation.lk

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