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Financial Crises and Labor: Does Tight Money Loosen Labor Rights?

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Summary. — Despite copious research on financial crises, many of their effects remain poorly understood. In this study, we examine how financial crises affect collective labor rights. We posit that the economic effects of these crises likely undermine the protection of collective labor rights. To test these propositions, we examine the impact of financial crises on collective labor rights in 46 developing countries from 1985 through 2002. We find that crises are detrimental to labor rights practices while having no significant effect on labor rights laws, and that their effect persists for up to five years after the crisis subsides. Our analysis thus suggests that financial crises pose a challenge to supporters of labor rights, as they are pivotal events that call into question the balance that exists between the state, capital, and labor, and that labor loses power in both the short and medium terms.
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Key words — financial crisis, labor rights, collective bargaining rights, economic shocks

1. INTRODUCTION

In the final weeks of 2001, Argentina faced a major financial crisis caused by a toxic combination of rampant external debt and currency convertibility problems. The crisis precipitated huge economic, political, and social shocks. Currency values plummeted, gross domestic product (GDP) fell by 15%, unemployment rose to 25%, and over half of Argentina's households tumbled into poverty. The country "exploded in a wave of rioting and protest" (Levitsky & Murillo, 2003, p. 155) which the government brutally repressed, resulting in at least two dozen deaths. In a matter of weeks, Argentina went from being "poster child to basket case" (Pastor & Wise, 2001, p. 60). Labor rights, already compromised by reforms in the 1990s, were further threatened as the economy imploded and unions faced a massive decline in their political and economic power. Though organized labor was able to "prevent major changes to collective labor law" (Etchemendy & Collier, 2007, p. 385), labor rights were undermined in the wake of cuts to public sector jobs and drastic increases in informal sector employment.

Yet over the next few years, labor was able to rebound. Labor markets tightened in the post-crisis economy and with the election of a labor-friendly regime in 2003, organized labor was able to achieve a level of "revitalization" that would have looked impossible in the immediate wake of the crisis (Etchemendy & Collier, 2007, p. 364). Through a series of strikes and collective bargaining negotiations, worker rights were improved in areas such as wages and working conditions (Etchemendy & Collier, 2007). While the Argentine labor force was altered by the crisis and labor groups were never able to fully regain their pre-crisis power, unions were able to reassert themselves and mitigate some of the effects of the crisis on labor.

As this example suggests, financial crises present a fundamental challenge to a country's economic and political system (Pepinsky, 2014; Serieux, Munthali, Sepehri, & White, 2012). Within this context, the fate of labor rights is particularly germane. In the short-term, workers face immediate threat to their economic well-being and labor groups are put on the defensive. In subsequent years, organized labor is faced with the challenge of reasserting itself in a political and economic system that has been transformed, possibly to the detriment of labor.

In this article, we systematically examine the extent to which financial shocks affect collective labor rights. A thorough analysis is essential to understand how economic shocks influence the balance between labor and capital, as well as whether possible changes in labor conditions persist after the crisis subsides. We posit that, on balance, financial crises bode poorly for labor rights, particularly those related to freedom of association and collective bargaining. The economic impact of financial crises – increased unemployment, use of contingent labor, reduced government spending, and lower wage levels – might directly undercut labor rights, especially those associated with job and wage security. Labor rights practices are likely to decline as corporations face increased incentives to loosen their adherence to extant labor laws, particularly those affecting the ability to quickly reduce their labor pool or adopt more flexible labor arrangements. Further, as states respond to a financial crisis, they might be less willing and able to effectively uphold extant labor laws, and hence inclined to decouple from these legal commitments. However, longer-term expectations are mixed, depending on whether labor is able to mobilize in response to the crisis or the crisis constitutes a transformative moment that alters the equilibrium between the state, capital, and labor.

To test these arguments, we assess the relationship between financial crises and labor rights. Specifically, we examine the impact of five different types of financial crises on collective labor rights for 46 low- and middle-income countries for the years 1985 through 2002. [1] Our results suggest that financial crises in general are related to the decoupling of labor practices from extant labor laws in developing countries. That is, crises are detrimental to labor rights practices while having no significant influence on labor rights laws. We find this general pattern holds in the relationship between total financial crises and labor rights, as well as across four of the five different types of crises. Furthermore, we find this impact to

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be persistent with the negative effect on labor rights practices enduring up to five years following the crisis.

We proceed with a brief overview of the relevant financial crises literature and present our theoretical framework to explain how financial shocks might undermine collective labor rights, the specific link to the decoupling of practice from law, and whether labor rights recover in the aftermath of crises. We then discuss the data and model specifications, and report the findings from the data analysis. We conclude with a discussion of the scholarly and policy implications of our research for financial crises, as well as the protection of labor rights.

2. THE POLITICAL ECONOMY OF FINANCIAL SHOCKS AND COLLECTIVE LABOR RIGHTS

The role of labor rights within the global economy is contentious. Though these rights are broadly recognized, their actual protection varies greatly across countries. Indeed, Kang (2012, pp. 1–2) bemoans the "paradox of trade union rights" replete with "public statements of support for trade union rights and their widespread violation." As such, a growing body of the literature has examined the linkages between organized labor and the global economy, as well as the roles of the state and capital in this relationship. Previous research explored how domestic political institutions and political stability affect labor rights (Mosley & Uno, 2007). Others examined the effect of external factors such as trade and foreign capital (Blanton & Blanton, 2012; Kucera, 2002; Mosley, 2011), international laws and treaties (Cole, 2013), IMF and World Bank policies (Abouharb & Cingranelli, 2007; Blanton, Blanton, & Peksen, 2015) and transnational labor movements and norms (Murillo & Schrank, 2005). Other research has provided further insights into how collective bargaining groups mobilize and respond to potential threats related to globalization (Kim & Kim, 2003).

Financial crises are also an important part of the global economic landscape, and considerable research has addressed many of their economic and political effects. Regarding the former, extant works have focused mainly on the employment effects of crises. Crises create several conditions that substantially affect the labor market. Firms lose capital, face an uncertain business environment, and have a more difficult time procuring additional funds (Bernal-Verdugo, Furceri, & Guillaume, 2013). In response, they often reduce their workforce. Indeed, empirical work in this area has found a robust relationship between crises and unemployment (Choudhry, Marelli, & Signorelli, 2012; World Bank, 2008). The employment effects can prove persistent, as firms may be hesitant to resume hiring even after the crisis abates and subsequent job growth is in the informal rather than formal sectors (Bernal-Verdugo *et al.*, 2013; Etchemendy & Collier, 2007; Skoufias, 2003). Crises also depress wages. Not only does the short-term supply of labor outstrip demand, but workers who transition to different industries as a result of these crises generally earn lower wages in their new jobs (McKenzie, 2004; Pratap & Quintin, 2011).

Though the main focus of the literature is on the labor market rather than labor rights *per se*, we expect that crises – and the economic turbulence that they create – bode poorly for the protection of worker rights, particularly those related to freedom of association and collective bargaining. According to the institutional theory of the firm, its sole responsibility is to maximize profits (Friedman, 1970). Hence, cutting costs and shoring up corporate profits might preclude the rights and welfare of employees as an organizational imperative.

Moreover, this dynamic is not limited to labor in countries with weak labor rights and standards; labor's wages and bargaining power may also be eroded in countries with stronger labor rights and standards due to factor price competition in the global market (Christensen & Wibbels, 2014). Financial crises may exacerbate this proclivity. For their part, "organizations act more conservatively and defensively" and thus "fail to balance the expectations of related parties" (Karaibrahimoglu, 2010, p. 383). In many respects, pursuing such strategies as laying off workers, reducing wages, and increasing reliance on contingent labor may directly diminish collective labor rights relating to job and wage security. Moreover, employment may shift increasingly into the informal sector, where there are generally minimal labor protections (Dhanani & Islam, 2002).

Financial crises also have substantial political impact. Most immediately, as capital dries up in the private sector, the government collects less revenue. This hinders its capacity to provide social spending and other public goods (Ha & Kang, 2015; Serieux *et al.*, 2012). Crises often draw attention to a state's economic system – particularly its shortcomings – and can create impetus for economic reform or even regime change (Chwieroth, 2010). A number of scholars have examined the ways in which states respond to financial crises and the implications for political systems (Gourevitch, 1986). They find that financial shocks create distributional pressures because crises impose immediate stress on the existing system and any policy responses or strategies for dealing with the crises connote a redistribution of resources between different actors (Pepinsky, 2014). The post-crisis outcome could reflect which domestic interests are better able to influence the policy responses in a manner advantageous to their interests (Lake, 2009; Rodrik, 1996).

Bringing this to bear on labor rights, crises create an immediate shortage of capital. This leads firms to cut costs, and often employees, to maintain profitability. For their part, labor groups seek to insulate workers from the effects of the crisis through the protection of labor rights, such as job security and wage guarantees (see Pepinsky, 2014; Stern, 1999). At the same time, cuts in public spending – commonly enacted in response to financial crises – often translate into job reductions within the public sector, which is a heavily unionized segment of the economy (Wibbels, 2006). On balance, the immediate economic effects of crises thus alter the distribution of power in favor of corporations as the public sector comes under fire and labor is put on the defensive.

Ostensibly, the task of balancing these competing interests falls upon the state. However, crises place substantial economic demands upon states, and weaken their ability and willingness to restore the pre-crisis equilibrium between capital and labor. While facing increased calls for public spending to mitigate the impact of crises (i.e., transfer payments and unemployment insurance), state tax revenues are drastically reduced. As a result, crises can inhibit state capacity to devote the resources necessary to enforce extant labor laws (Abouharb & Cingranelli, 2007; ILO/World Bank, 2012), such as workplace inspectors and legal representatives to prosecute corporations for violating labor laws.

On a broader scale, given the mobility of capital and the urgent need to attract it in times of crisis, governments might be inclined to increase their support of corporations in an effort to retain their investment, even to the detriment of labor (Blanton & Blanton, 2012). For example, during the Asian financial crisis, market pressures "heightened the employer imperative for flexibility and cost minimization, increased employer bargaining power, and led to a decline in trade

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