

# **The Effect on International Competitiveness of Differing Labour Standards in the Textile Industry of the NIS and the EU**

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## **Abstract**

The project which generated this paper arose from continuing concern in the European Union about the persistence of high unemployment and the likely effects of economic reforms in the Newly Independent States. The study brought together researchers from four countries: Finland and the United Kingdom in the EU and Belarus and Russia in the NIS. The purpose was to examine the impact that differing labour standards in the two NIS countries and the two EU countries have and are likely to have on the ability of companies in each country to compete internationally. The core research activity comprised a small number of in-depth case studies of firms in the textile sector, enabling comparisons to be made between the industries in each of the four countries.

The lack of structure of labour markets in the NIS and their comparatively low labour costs posed a potential threat to the competitive position of the EU and this study set out to understand the relevant issues more fully from a number of different perspectives. These included comparing labour costs and productivity, social costs such as health and safety, pensions and other benefits and exploring the impact of investment on productivity. Ultimately the study focused on how a levelling up of labour standards in the NIS would impact on the EU Member States.

This paper sets out the findings of the case studies within the textile industries of the respective countries. These specific finds are presented within the general context of a comparison of labour market conditions.

For the most part, textile firms in the NIS are in a more vulnerable situation than their EU counterparts, with falling domestic demand in Russia and severe raw materials difficulties in Belarus typifying the problems. Lower labour costs in the NIS firms are counteracted by poor productivity and quality issues. Finnish and UK firms also feel vulnerable in a world market, but most have challenged this by developing higher quality, niche products. Higher labour standards does not currently represent a major factor affecting the competitive position of EU firms compared with those in the NIS.

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This research project was undertaken in four countries, Belarus, Finland, Russia and the United Kingdom, during 1995-97.

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## The Effect on International Competitiveness of Differing Labour Standards in the Textile Industry of the NIS and the EU

### Introduction

#### Background

This paper presents partial findings of a study funded by the Tacis - ACE<sup>1</sup> programme on 'differing labour standards and their effects on international competitiveness'. The study arose from continuing concern in the European Union (EU) about the persistence of high unemployment and the likely effects of economic reforms in the former countries of the New Independent States (NIS). The basic premise was that in these transitional countries, the lack of structure in labour markets and the comparatively low costs of employment posed a threat to the competitive position of the EU. Concerns over product dumping and the diversion of investment from the EU to the NIS were at the forefront of the issues addressed by the research.

More specifically the research focused on the following key issues:

- comparisons of labour costs and productivity
- comparisons of social costs such as health and safety at work provisions, pensions, unemployment benefits, maternity/paternity rights, redundancy and dismissal provisions
- the impact of investment on productivity and the extent to which foreign investors are seeking to exploit the lower costs in the NIS
- an assessment of the quality control issues and the extent to which changes in quality in the NIS will impact upon industries in the EU
- a consideration of changes in, and the levelling up, of labour standards and the potential impact on international trade

The study brought together researchers from four countries: in the EU, Finland and the United Kingdom, and in the NIS, Belarus and the Russian Federation (hereafter simply referred to as Russia).

## **Objectives**

The overall objective of the study was to understand more fully the issues surrounding the effects of differing labour standards on international competitiveness. However within this broader objective there were a number of specific goals, summarised as follows:

- to develop a set of appropriate policy recommendations to inform EU policy and decision-making in the sphere of economic reform and the integration of the transitional economies
- to develop and improve the understanding of the international trade implications of the transition process in the countries of the NIS
- to generate and improve understanding of international comparisons of labour standards and their implications
- to develop intra-industry comparisons of total labour costs (direct and indirect) between the partner countries
- to establish the extent to which the textile industries in the NIS countries will be able to compete directly with similar industries in the EU and to test their ability to attract inward investment away from the EU

In order to meet these objectives, the study gathered a mixture of quantitative and qualitative information from the textile, steel and fertiliser industries. This paper focuses on the textile sector. The textile sector was chosen as representative of those industries likely to be significantly affected by more open international competition and because of its common interest to all four countries involved with the study.

## **Methodology**

The method of approach involved a number of distinct, though inter-related activities, the key ones of which are described below:

- inaugural workshop bringing all partners together to exchange basic information and agree the study parameters, basic approach and timetable (this was held in Moscow in December 1995);
- preparation of contextual information on the national labour markets, including basic indicators of economy and employment and basic legislative provisions in the area of labour standards;
- case studies of firms in the textile sector.

The employer case studies represent the core research activity. The approach was to isolate those sub-sectors (ISIC Classes) of most relevance to the study and its objectives and to each partner country ( ISIC classes 1711, 1712). A schedule of target case studies, stratified by sub-sector and size, was agreed between the partners, and this formed the basis of the case study selection.

Each partner country began the case study work by selecting and completing a study of one pilot firm. For the pilots a draft *information request* and *discussion guide* were developed to ensure a consistency of approach in the interviews. However, it was necessary to modify the structure of the questions to fit with national conventions and this adaptation process was the responsibility of the researchers in each partner country. Firms in each country displayed varying levels of familiarity with responding to such enquiries and these characteristics have been taken into account. In the UK, for example, there is a tradition of qualitative interviews with employers, where discussions tend to be semi-structured and can range across a number of issues. By contrast, in Belarus there is a preference for inquiries that ask for precise information and so with less room in interviews for exploring the topics in a more qualitative way.

The UK research team drew up a common sampling frame for the case studies to be used by each research team, and a common discussion guide for the case study interviews. Each research team then identified and contacted appropriate companies in their country in conformity with the agreed sampling frame.

Although the sampling frame used was common in terms of ISIC codes, numbers of companies in each industry and in each employment size category, some variation was allowed to ensure that case studies conducted in each country were fully reflective of the industry in that particular country. For example, firms in the NIS countries are on the whole very large, whereas companies in Finland tend to be relatively small. It was deemed preferable to conduct a small number of in-depth case studies, rather than a large number of less detailed studies, as this would enable more meaningful conclusions to be drawn. Case studies were completed in all four countries by the end of 1996, and exchanged between the participating research teams. Subsequently a workshop involving all participating researchers was held in Minsk in May 1997, with the final report being written by the UK research team.

This project has involved researchers from four countries, with differing backgrounds, cultures and methodological traditions. For example, whereas in the UK and Finland, the practice of semi-structured qualitative interviewing is well established, in the NIS countries this is not the tradition. Hence, although each research team used a common format, there were initially some difficulties in ensuring a comparable product. There have also been communications difficulties, in particular with Belarus, due to a shortage of telephone lines, uncertain postal communications, and a lack of email facilities.

It proved difficult to obtain quantitative data which is fully comparable across all four countries. In part this is due to the vagaries of national systems, but also due to factors such as the fixed exchange rate of Belarus. For example, figures on productivity and wages in Belarus, which while available, are highly misleading due

to the official exchange rate in which they are quoted. Such problems render meaningful comparisons extremely difficult and so quantitative comparisons across all four countries have not been attempted, but instead the analysis has concentrated on qualitative comparisons with country specific figures quoted where appropriate and meaningful.

Even within the EU, comparisons between the UK and Finland are not as straightforward as may appear, and the added dimension of Belarus and Russia makes for a difficult situation. The use of labour market statistics in this context is problematic, especially given the acknowledged unreliability of information from the transitional states. Nevertheless, the available statistics have been used where possible alongside more qualitative information.

### **Labour Market Context**

#### Key Issues

This section sets out the broad labour market contexts within which the four study countries operate, drawing comparisons as appropriate, with the primary aim of aiding understanding of the subsequent textile industry section. In doing so the discussion focuses on the following key areas:

- demographic indicators
- employment
- unemployment
- social partners
- wage determination
- labour legislation
- economic performance

#### Demographic Trends

Basic demographic indicators are presented in Table 3.1. They show the relative size of the four countries in term of population, with Russia and to a lesser extent the UK contrasting sharply with the much smaller populations of Belarus and Finland. The size of the working population will be influenced by the age structure of the overall population and here all four countries are facing ageing populations which will impact both on the available population for the labour market and the number of dependants outside the labour market.

Activity rates for both men and women have traditionally been higher in the transitional states than in the EU countries, and this is still the case, despite the disproportionate job losses among women, (which in Russia are expected to worsen as labour market legislation protecting female employment is removed or breached). In 1995 the activity rate for women in Russia fell to 56.3% from a figure of 61.6% only two years earlier. Over the same period the male activity rate has also fallen sharply. This contrasts with the experience in the EU countries, where increased numbers of women are entering the labour market, and with Belarus, where job losses have not been permitted.

**Table 3.1: Demographic Indicators**

<b>Indicator</b>	<b>Belarus (1995)</b>	<b>Finland (1995)</b>	<b>Russia (1995)</b>	<b>UK (1995)</b>
Population (million)	10.3	5.1	147.9	58.4
Working population (million)	5.9	3.4	74.0	38.1
Employment (million)	4.4	1.9	72.0	25.1
Activity rate (%)	74.6	69.9	63.1	72.8
Female activity rate (%)	-	67.2	56.3	64.6

*Source: National Statistics*

### Employment

In comparison with the two EU countries, Belarus and Russia have a much larger proportion of total employment in agriculture with 19.1% and 15.1% respectively. However, even between the two EU countries there is a marked difference, with the UK having a comparatively small proportion of employment in agriculture at 2.1% compared with 8.6% in Finland. Figures for employment in industry are, however, more consistent between the four countries ranging from 27.8% in the UK, which is only marginally higher than the smallest proportion - in Finland (26.3%). Comparisons of service sector employment across the four countries are not possible due to the deficiencies of the Belarusan figures, although between the three remaining countries the two EU Member States have much higher service sector employment than Russia, with the highest in the UK.

**Table 3.2: Employment by Broad Sector**  
(1995, Percentage of Total Employment)

<b>Sector</b>	<b>Belarus</b>	<b>Finland</b>	<b>Russia</b>	<b>UK</b>
Agriculture	19.1	8.6	15.1	2.1
Industry	27.6	26.3	27.1	27.8
Services	*29.3	65.1	57.8	70.1

\* in 'non-material sphere', excludes public sector (for example civil service, government, etc.)

*Source: National Statistics*

It is difficult to be precise about the reliability of the Russian employment figures since the estimated large informal sector (accounting for anything between 20-40% of overall economic activity) will distort the information shown. Employment in the informal sector is not concentrated in any particular industry but widely distributed in the economy. However, services may be a higher proportion of the informal than the formal economy. In Belarus, estimates of the size of the informal economy are equally precarious, although 36-46% has been estimated on the basis of changing cash shares. Other more cautiously based estimates put it at between 5.5% and 13.5% of GDP. In the two EU Member States there is undoubtedly some informal economic activity, but it is generally reckoned to be comparatively small and does not represent the same potential threat to economic policy as is the case in the transitional states. In the UK, for example, the informal sector is thought to be relatively small and concentrated in certain occupational areas such as construction and personal services.

### Employment Status

It would be expected that these variations in the sectoral distribution of employment would be reflected in the types of employment status found in each country, but this is only partly confirmed by the information in Table 3.3. For example, in EU Member States with high levels of employment in agriculture there is an associated high proportion of self employment (representing the farm owners). This is not the case in either Belarus or Russia where, despite high levels of agricultural employment, self employment is comparatively small at 7.2% and 9.4% respectively. Finland, with a higher proportion of agricultural employment than the UK, has a correspondingly higher level of self employment. A similar argument applies to the number of family workers, and here the expected relationship with high agricultural employment obtains in Belarus, although figures not being available for Russia.

**Table 3.3: Employment Status**  
(1995, Percentage of total employment)

<b>Employment Status</b>	<b>Belarus</b>	<b>Finland</b>	<b>Russia</b>	<b>UK</b>
Employees	80.4	84.2	90.6	86.5
Self employed	7.2	14.3	9.4	12.9
Family workers	12.0	1.5	NA	0.6
Temporary workers	NA	12.9	NA	6.3
Part-time workers	0.9	8.4	4.0*	3.8

\* Includes only those voluntarily working part-time.

Source: National Statistics

In the two EU Member States the number of those with fixed term contracts is significant, but the use of such contracts is well established. In Finland there are over twice as many temporary workers as there are in the UK. By contrast, part-time working is far higher in the UK than in Finland or Russia, with over one quarter of all those in employment working part-time (mostly because they want to). In the UK and

Finland the majority of part-time workers are women. The Russian figures on part-time working provide only a partial picture since they do not take into account the increasingly common factor of those working less than full-time because they have had their normal hours cut by the firm. Further, in the informal economy there may be much moonlighting by (officially) full-time workers who are in practice under-employed. Voluntary part-time working in Belarus is not common practice, hence the low figure of less than 1% working part-time.

### Unemployment

Of all the labour market statistics presented here, those on unemployment present the greatest challenge in comparisons between the four countries. Within the EU the problem is less severe in that the measure used in Table 3.4 for Finland and the UK is derived from *Labour Force Survey* sources which are carried out in each Member State along reasonably comparable lines. For these two countries the statistics for 1995 show that Finland has a comparatively high rate of unemployment, well over twice that of the UK.

**Table 3.4: Unemployment**  
(1995, Percentages)

<b>Country</b>	<b>Unemployment Rate</b>
Belarus	2.4
Finland	18.4
Russia	7.9
UK	8.3

*Source: National Statistics*

The unemployment rates of 2.4% for Belarus and 7.9% for Russia are wholly misleading. In the case of Belarus there is substantial hidden unemployment and underemployment with firms compelled to hold on to labour they do not really need, as evidenced in the high level of unpaid layoffs. Unemployment is not yet allowed to become visible. This is also still the case to some extent in Russia with, for example, the statutory costs of redundancy a definite disincentive for firms to release labour they do not need. There is also a high level of hidden unemployment estimated at over 9% of all employment and over 28% of employment in light industry. Underemployment is also prevalent with an estimated 8.8% working below their capabilities across all industries. 'Forced vacations' without pay (in effect unpaid temporary layoffs) have increased and are a common feature of larger firms.

### Social Partners

Between Finland and the UK there are substantial differences in the social partner framework and their involvement in such activities as collective bargaining, tripartite consultations, and the like. However, these differences have to be seen in the context

of free, independent trade unions and employer bodies with a long tradition in both countries. In Belarus and Russia the prevalence of similarly based organisations is less clear and in order to illustrate this the basic parameters of the social partners in all four countries are summarised:

- **Finland:** Trade union membership is high at almost 100%, mostly because the unions are involved with the payment of unemployment benefits. There are some 81 individual trade unions grouped into three main confederations. For employers there are seven employers' associations. These do not represent all firms, but firms which are not members must also follow the collective bargaining agreements reached.
- **United Kingdom:** Membership has been steadily declining since 1989. In 1995 there were around 7.2 million trade union members indicating a membership density of under one third. There are in excess of 200 individual trade unions with a mix of general, industrial and craft based, although amalgamations have brought the overall figure down. The sole confederation is the Trades Union Congress (TUC) which has the majority of individual unions as members. There is a dominant employers' association, the Confederation of British Industry (CBI). It can claim only a small proportion of total firms as members but most of the largest are represented. Other federations exist and tend to be organised along sectoral lines.
- **Belarus:** There is one dominant government-backed trade union federation, the FPB or Federation of Trade Unions of the Republic of Belarus, which has over 31,000 organisations at branch, region and plant levels and claims over 4 million members, amounting to almost all those in employment. Union membership is seen as a normal requirement of employment, and although there are some additional small independent unions emerging, they are at present insignificant. For employers there are six employers' associations of a general nature.
- **Russia:** There are more than 100 separate trade unions with a combined membership of over 50 million, or around 75% of those in employment. Many of these unions were operational before the reform process started and have been slow to change their approach. The majority form the main confederation, the FNPR (Federation of Independent Trade Unions of Russia) but there are some additional smaller federations emerging which are particularly attractive to the new trade unions. Employers' associations have emerged since the reforms, with three growing national bodies and many regional associations.

The degree of involvement of the social partners in fundamental issues such as collective bargaining varies a great deal and is at its most intense in Finland where both sides are involved in forming sectoral agreements. In addition, if problems occur and the parties cannot make an agreement, the partners work with the government under a tripartite framework that sets a general agreement on incomes policy for the whole economy on an annual basis. This differs substantially from the UK where

there currently is no tripartite framework that consults with the social partners. In addition, the main employer and trade union confederations do not get involved in collective bargaining, being seen more as pressure groups.

In Belarus the closeness of the trade unions to the state indicates that they will reflect government policy on wage increases and such matters, suggesting that the degree of 'bargaining' may be limited. This was also the case in Russia, although more recently the unions have themselves been reformed and are involved with collective bargaining and protecting the interests of their members. The law on collective agreements allows them to be conducted at federal and regional levels and for specific professions at a local level, although the most common types of agreement reached are those at federal and regional levels for all industries and federal ones for specific sectors and occupations.

### Wage Determination

The collective bargaining arrangements outlined above suggest a highly formalised process in Finland and Belarus, with national economic policy providing a backdrop against which sectoral or enterprise level wages are set. In the Finnish case tripartite discussions are held only if employers' and employees' central organisations cannot agree on wage increases, otherwise agreements typically establish a general level of pay increases and possibly other terms and conditions of employment. The agreement currently in force, for example, provides for minimum increases each year to the end of the agreement period (January 1998) as well as provisions for low paid workers and the prevention of a widening income differentials. However, outside this broad agreement, individual firms have the right to negotiate and award other changes to remuneration but this is normally done through the consultative machinery in place.

In principle, in Belarus enterprises are free to determine the wages of their employees (subject to the provisions of the minimum wage). In practice virtually all follow the public sector pay scales; a grid of 28 wage groups, all based on percentage mark-ups over the first budgetary wage scale (which is slightly above the minimum wage). Thus there is a great deal of uniformity in wages between industries, although variations do exist. Clearly the national minimum wage is a fundamental part of the process and, it is seen as an instrument of economic policy and benchmark for the setting of social benefits such as pensions and child allowances. Over the past few years the real level of the minimum wage has steadily declined under the pressure of inflation.

This system differs from the current situation in the UK where government has only a minimal involvement in wage setting. There is currently no national minimum wage and basic rates are set only in the agricultural sector. Collective bargaining (normally between the employer and trade union) is still important in setting base rates of pay and establishing minimum terms and conditions in the manufacturing, transport and financial services sectors and in the public sector (health, education, etc.). Yet the trend even in these sectors is towards fragmentation with local and individually negotiated remuneration packages, with performance related pay increasingly used as an incentive.

In Russia the Russian Tripartite Commission has an intermediary role in collective bargaining, although industry based agreements and (increasingly) plant-based agreements are establishing themselves as the norm. There is a minimum wage which is set by government and updated according to cost of living measures. The level of the minimum wage has been set well below what can be deemed a 'survival wage' and so few workers actually receive the minimum. Prior to 1995 the minimum wage was used as a benchmark to determine whether firms would pay an 'excess wage tax' which was set at a level six times the minimum wage, after which tax rates would increase progressively. However, firms manoeuvred around this by keeping low paid workers on the payroll so that other employees could be paid more than the threshold but without attracting the tax.

Many workers in Belarus and Russia currently suffer from late payment of wages, with 2-3 months being typical in Russia. This arises from cash flow problems caused by customer firms, and from a lack of funds to the firms through the taxation system (since most are still dependent on the public sector). This is not a situation likely to arise in the EU Member States where legislation protects workers' rights to receive their income, even in the event of bankruptcies.

#### Labour Legislation

All four countries have a degree of legislation geared towards employment matters, although there are substantial differences in the intensity of the measures and their enforcement. It is not the purpose of this report to provide a comprehensive account of all such legislation, but more it is to provide a view on the effects of the overall package on international competitiveness. The judgement of employers on this matter is covered in the three subsequent case studies and here it is appropriate to make some broader statements on the possible effects.

When assessing the effects of labour legislation it may be too simplistic to concentrate on the provisions of the law in such matters. While all employers are expected to comply with the statutory provisions, it could also be argued that those provisions of a non-statutory nature, but which have, by virtue of custom and practice, become normal provisions should also be included. In many cases, employers who choose to ignore these established, but non-statutory, provisions will tend to lose out when it comes to the recruitment and retention of employees. The issue is particularly important for EU Member States where there tends to be a higher level of occupational mobility than in the transitional states. Also, tighter labour markets (as proxied by a low level of unemployment) will also experience greater movement of labour between jobs as employers bid up wages in order to achieve their labour needs. However, of the four countries studied, this scenario would tend to apply principally to the UK where unemployment is comparatively low, although in all countries particular occupations and sectors will display their own supply and demand conditions.

Table 3.5 summarises the extent of statutory provisions in all four countries using the main headings emerging from this study. The information shows that all four countries have basic provisions covering such aspects of employment as pensions,

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unemployment insurance and holidays, etc., albeit set at different levels, thereby constituting different proportions of non-wage costs to employers. Also some of the statutory provisions may allow for rather partial coverage of the issue. For example, sick pay in the UK is governed by the terms of the Statutory Sick Pay Scheme but this only guarantees a minimum level of payment from the employer-contributed fund and for a maximum period of 28 weeks. However, it is common practice amongst the larger employers to have an additional privately funded sick pay scheme which allows employees to claim a much higher proportion of their earnings for a longer period of absence due to sickness.

It is problematic to go one stage further in this analysis by including actual levels of provision because of the different contexts within which they operate and the very real difficulties in finding comparable exchange rates, etc. However, it is evident that in Russia, for example, the statutory provisions are often inadequate and suffer from late payment.

**Table 3.5: Comparisons of Statutory Provisions**  
(Indicates whether statutory provisions exist (√) or not (X))

<b>Statutory Provision</b>	<b>Belarus</b>	<b>Finland</b>	<b>Russia</b>	<b>UK</b>
Social security	√	√	√	√
Pension (basic)	√	√	√	√
Pension (additional)	X	√	X	X
Unemployment insurance	X	√	√	√
Accident insurance	X	√	√	√
Sick pay	√	√	√	√
Maternity leave/pay	√	√	√	√
Paternity leave/pay	X	√	X	X
Accident pay	√	√	√	√
Holiday pay	√	√	√	√
Layoff pay	X	√	X	√
Redundancy notice/pay	X	√	√	√
Minimum wage	√	√	√	X
Working time	X	√	X	X
Equal opportunity	X	√	√	√
Employment of disabled	√	√	√	√
Health and safety at work	√	√	√	√

Source: National information.

Table 3.6 provides a similar analysis for those non-statutory provisions by employers which have become established practice amongst at least the larger employers. The EU Member States, for example, frequently provide a contributory pension scheme that is additional to the state pension covered by general taxation. Employer-based pensions are normally made up from contributions from employer and employee and in the UK represent one of the largest elements of non-wage costs for employers,

often adding upwards of 10% to the wage bill. Insofar as they are voluntary they could, theoretically, be withdrawn by employers at any time. In reality, however, they have become an intrinsic part of the employee's remuneration package and in some cases have been enshrined in collective agreements which, of course, provides a legal limit on what the employer can do with such benefits.

**Table 3.6: Comparisons of Non-Statutory Provisions**  
(Indicates whether provisions exist (✓) or not (X))

<b>Non-Statutory Provision</b>	<b>Belarus</b>	<b>Finland</b>	<b>Russia</b>	<b>UK</b>
Pensions	X	✓	X	✓
Workplace catering	✓	✓	✓	✓
Employee housing	✓	X	✓	X
Holiday accommodation	✓	✓	✓	X
Medical/health service	✓	✓	✓	✓
Additional leave	X	✓	X	✓
Protective clothing	✓	✓	✓	✓

Source: National information

The UK is, by common consent, the least regulated labour market in the EU. It relies on a 'voluntarist' approach which basically means that the state will remain outside the employment relationship allowing employers and employees (or their representative bodies) to strike whatever contractual relationships that are appropriate for them, subject to a minimum of statutory provisions. This situation has endured despite the UK's membership of the EU. Some reliance is placed on 'codes of practice' in areas such as good industrial relations or disciplinary practices which employers are encouraged to follow<sup>3</sup>. In taking this approach the UK amongst the four countries studied here therefore represents the polar case in terms of labour market regulation. It also indicates that in the UK the non-wage costs are generally lower than those with more highly regulated labour markets (such as Finland), although the custom and practice of non-statutory elements should be brought into the debate. However, by their very nature these will vary in scale, thus making any meaningful comparisons impossible.

#### Economic Indicators

Comparisons of key economic indicators between the four countries is severely hampered by a lack of comparable data. It is accepted that the economic activity of the two EU Member States, as measured by GDP per capita for example, will far exceed those of Belarus and Russia. However, the extent of this difference cannot be judged from the official statistics available in the NIS, where reliance on the traditional methods of measurement is problematic.

For Belarus and Russia it is possible to identify those key features of economic life that they have had to grapple with since the reform process started, as listed below:

- falling output
- high levels of inflation
- low savings ratio
- falling government tax revenues
- high interest rates
- reducing value of the currency

In the case of Russia, there are signs of improvement in some of the economic indicators as policy achieves a degree of stability. Inflation, for example, peaked in 1992 at around 2,600% per annum and has since fallen back to a comparatively moderate 27% in 1996. However, the tight monetary policy that has been behind such improvements has also had a negative effect on the economy, encouraging the non-payment of debts which causes problems for businesses and their workers alike.

Belarus displays many of the characteristics of economic change that Russia is experiencing (particularly high inflation, falling output and currency values) but here the changes are taking place against a somewhat different policy backdrop. In Belarus the pace of privatisation has been much slower. Official figures quoted by the IMF suggest that the overall share of employment in so-called public enterprises had fallen from 81% in 1985 to 68% in 1993. This suggests a much stronger direct involvement of government in the management of the economy. However, the fact that the country is still experiencing the same economic effects as others which have liberalised further, indicates that economic and labour market problems are not being overcome but simply stored up for the future.

#### Overview

All four countries are facing similar kinds of demographic pressure, such as an ageing population, but activity rates are falling rapidly in Russia, especially for women. This is against the general trend observed in the EU Member States where female activity rates are tending to increase. Much of this increase is in part-time working which is yet to establish itself in Belarus and is relatively small in Russia. The UK has one of the highest proportions of part-time workers in the EU with almost one in four workers, and one in two women in employment being part-time.

Other indicative statistics of a changing labour market would be the proportion of those in employment on fixed term contracts (temporary workers). Here there is only information available for the EU Member States which shows Finland with twice the proportion of temporary workers as the UK. Self employment has been growing in all four countries, although Belarus and Russia are some way behind the proportions in Finland or the UK. Unfortunately the statistics are much more less reliable on unemployment and meaningful comparisons between the four countries cannot be made. It is evident that there is considerable hidden unemployment in Belarus and Russia, with underemployment a significant problem bolstered by government policy towards the release of employees in enterprises.

The role of the social partners is still emerging in the NIS. Trade unions are developing their own separate identity and employers' associations are in their infancy. Comparisons with the EU Member States are also complicated by differences within the EU, and this is clearly illustrated by the two examples of Finland and the UK. The UK, with its falling trade union membership and influence and absence of any tripartite framework, represents the polar case within the EU. By contrast Finland follows more closely the European 'Social Model' of fairly formalised structures and procedures in such areas as collective agreements and incomes policy. The situation illustrates above all that there is no single approach to the regulation of the labour market within the EU and suggests that the transitional states would be advised to adopt policies and procedures that suit their local conditions best.

## **THE TEXTILE INDUSTRY**

### **Background**

The case study firms produce a wide variety of products ranging from upstream yarn and fibre production (both natural and synthetic), to fabric production (both natural and synthetic), and downstream textile articles. Products range from low-technology commodity and standardised products, to niche products at the higher end of the technology scale.

Among the EU producers, maintaining a competitive edge involves a strong emphasis on quality, niche marketing, reliability and speed of delivery, a willingness to supply small batch production and responsiveness (for example new fashion colours). Location facilitates this competitive response ability. The Finnish producers place strong emphasis on environmental considerations, leading some of them to use this as a marketing advantage in the environmentally aware markets of the EU. UK producers also consider quality standards to be of paramount importance in attracting customers. The Finnish and UK producers are unable to compete on costs with producers from outside the EU/USA or with lower cost producers from the southern EU countries, and so compete on other attributes. Some Finnish producers are now facing competition from UK producers with "extremely low prices". Some UK producers report being able to sell into other EU markets on a cost basis due to relatively low UK labour costs and fewer labour market regulations (for example the absence of a minimum wage).

Textile firms in the NIS are experiencing difficulty in competing on a cost basis with their relatively high social costs of labour, low labour productivity and outdated technology and automation. They also need to search for new markets to replace the shortfall in domestic demand. The break-up of the USSR has resulted in the loss of protected markets in the other former republics. Outdated machinery and inadequate automation exacerbate problems in producing quality products, leading to a proliferation of low value added products. A number of the Russian producers are trying to obtain modern machinery to enable them to switch production out of cotton based production where they are experiencing supply problems, and into synthetics

and linen production. Both Belarus and Russia have experienced and are continuing to experience a serious under-investment problem, leading to a search for Western investors.

Redundancies in the textile sector have been a feature of the past decade or more in all four countries studied. Firms are faced with the common problems of an older age profile of workers, low labour turnover, and in the case of Belarus and Russia, surplus labour.

#### Belarus

There are 220 enterprises in the textile industry, the main products being linen fibre, yarn (cotton, wool, silk, linen, non-woven material), carpets and carpet derivatives. The industry represents approximately 4.7 % of GDP (1996) and is the fourth most important export earner accounting for 12.2 % of total exports by value in 1996. The main textile exports are linen fibre and cotton fabric, with the main destinations being Russia (over one third), Germany, Turkey, Switzerland, Poland, Italy, the Netherlands, and Ukraine.

The 1990s have seen a reduction in industry output, as shown in Table 4.1.

**Table 4.1: Production of Textile Products Belarus 1990-95**

	1990	1995
Flax fibre, thous.t.	69,8	52,3
Yarn, ths.	120,7	36,8
Cotton	50,5	9,1
Woollen	40,2	11,6
Linen	30,0	16,1
Fabrics, mllsq.m.	511,4	230,3
Cotton	140,4	32,6
Woollen	46,3	7,3
Silk	209,8	33,4
Linen	94,5	41,5
Non-woven materials	20,4	115,5
Carpets and carpet derivatives, th.sq.m.	20733	4167

*Source: National Statistics*

The industry is suffering from an acute shortage of raw materials, particularly cotton, formerly obtained from the Central Asian republics of the USSR. Prices of raw cotton have now increased to those levels found on the world commodity markets, and quality has fallen. Shortage of hard currency precludes obtaining supplies from elsewhere.

### Russia

There are approximately 700 large and medium sized textile firms in Russia plus many small enterprises not identified in the statistics. The industry is becoming less and less important to the Russian economy, as imports crowd out domestic production. In 1996 the industry represented around 0.9% GDP, and this is down by 26% compared with 1995. This decline represents the biggest production fall of all Russian industries. The main products are fabrics (cotton, flax, wool, silk) and carpets. Exports are negligible, as is Russia's percentage of world trade in textiles. However, the industry is significant in employment terms, with around 600,000 people, representing some 0.85% of the total workforce.

### Finland

The Finnish textile industry comprises some 116 firms, and output has consistently fallen over the past decade from a peak index of 120.4 in 1985, to 92 in 1994 (1990 = 100).

The main products are felts and fabrics for paper machines, non-wovens and waddings, cloth, finishing of textiles, knitted fabrics, yarn , and interior fabric. The main exports are hospital textiles and bandages, non-wovens and non-woven products, with 43% of these going to the EU, 23% to EFTA and 25% to other European countries. The main three export destinations are Sweden, Estonia and Germany. The numbers of workers employed in each branch of the industry are shown in Table 4.2.

**Table 4.2: Employment in the Finnish Textile Industry**

Branch	1994
1. Manufacturing of textiles	7294
1.1 Manufacturing of yarns and cloth	1244
1.2 Manufacturing of knitted fabrics and goods	3025
1.3 Manufacturing of other textiles	3024

*Source: National Statistics*

### United Kingdom

The UK textile industry is large and diverse, producing a wide variety of products, mostly high tech or specialised products with the emphasis primarily on quality and niche markets. The industry is geographically concentrated in the North West and Midlands and has a predominantly female workforce. In value terms, imports exceed exports both of textile fibres and of textile manufactures. Output in most categories of production has fallen over the 1990s, as has total employment by almost 12% between 1991 and 1996. The breakdown of employment by broad sector is shown in Table 4.3.

*Table 4.3: UK Textile Industry Employment*

Sector	1996
Manufacture of textiles and textile products	332
Of textiles	181
Of made-up textile articles except apparel	*33
Of textiles excluding made-up textile	*137

\*figures for Great Britain

Source: National Statistics

### Labour Costs and Productivity Issues

#### Employment

Employment in textiles has fallen significantly during the 1990s in all four countries. For example, the Belarusian industry has shed 10,000 workers since 1994, or around 12.5% of the industry workforce, and only one case study firm has had the opposite experience. In addition to labour shedding, it is estimated that there remain 22,000 surplus workers in textile firms in Belarus. As discussed elsewhere, the Belarusian government has had a no-redundancies policy in place in 1996, which has precluded further labour shedding. Several case study firms intimated that should this policy be discontinued, further redundancies would be implemented. The Russian case study firms have also experienced falling employment in spite of the high cost of redundancies, but surplus labour is still prevalent. Every case study firm had made some redundancies. In one Finnish firm redundancies had amounted to 50% of the workforce in 1996, whilst another is currently taking on new staff for the first time in 10 years. In the UK most, but not all, case study firms had made redundancies, and none were anticipating significant recruitment.

#### Short-Time Working

Most of the case study firms in Belarus and Russia have experienced short-time working during the 1990s, taking the form either of a short working week, or, more commonly, shutting down altogether. In the Russian companies, short-time working is the rule rather than the exception. One company had worked for only three months out of the last twelve. Surplus labour interacts with a sharp decline in the demand for the products. However, this downturn in consumer demand is not a feature of the EU producers studied.

## Wages

In all four countries, wages in the industry are low relative to the average wage. In the NIS, surplus labour exacerbates this differential. For example, in one Belarusian firm average wages are half of the average industrial wage. Overall wages constitute 6-8% of production costs in Belarusian textile companies. Wages in the textile companies in Russia are in the lowest segment of all industries, and in several of the case study companies, the average wage is below subsistence level. In the UK, import pressure keeps wages down, as does high unemployment in the regions in which the industry is concentrated. The strong geographical concentration of the Finnish industry has the same effect. Delayed payment of wages is common in the Russian industry, primarily due to the difficulty of customer firms in meeting their bills.

## Technology and Automation

In the use of technology and automation in the production process there is a gulf between the NIS producers and those in the EU. The NIS producers are without exception working with ageing equipment. For example, in one of the Belarusian case study firms, of the 19 different types of equipment in use, one type (15 machines) dates from 1959, another type (8 machines) from the 1960s, with the majority of the rest of the equipment being of 1970s vintage. Given the technological progress which has been made in this industry in recent years, this is a competitive disadvantage, as well as impacting negatively on the quality of production. Currently there are no resources for investment in modern technology. Low productivity due to ageing equipment and outdated automation interacts with surplus labour, resulting in extremely low labour productivity compared to the EU producers.

The Russian producers face similar problems. Equipment in the Russian case study firms dates primarily from the 1970s and resources for investment are currently not forthcoming. By contrast, the EU firms are primarily using the latest equipment, automation and technology, resulting in high labour productivity and the ability to produce quality products to meet the requirements of EU and US markets. Despite some of the Finnish firms reporting outdated technology, when compared to that in use in the NIS companies, it is modern. These firms are primarily those which inherited their equipment from a previous firm. One of the UK firms claims to have the most up to date equipment, having made a large capital investment in a brand new integrated production facility in 1994.

## Productivity

Labour productivity differs markedly between the NIS and EU producers, partly due to the factors discussed above. Differences in technology, automation, age of equipment, levels of employment, all affect labour productivity. In addition, differences in working practices and pay systems must be brought into the debate. The much lower labour productivity of the NIS producers counteracts the benefits from their much lower labour costs. Whereas the EU producers have very much

higher total costs of labour, they also have very much higher labour productivity. Most of the EU producers have increased their productivity in recent years by increased automation, improving technology, downsizing, instigating “cultural change” programmes, and bringing in productivity-linked incentive pay schemes. Belarusan statistics on labour productivity are highly misleading, partly due to the exchange rate problems discussed elsewhere, but due also to political factors. Productivity has not been improving during the 1990s, as the figures might suggest, nor is it likely to do so in the foreseeable future unless the no redundancies policy is removed and there is significant investment in new technology and automation.

### Working Practices

Regarding issues such as multiskilling and flexibility, none of the NIS firms have introduced such arrangements yet. Changes in working practices are impeded by the inability to downsize. Some of the UK firms demonstrated increasing interest in multiskilling, whilst others have yet to take this on board. One firm, producing at the lower end of the technology scale, maintains the traditional demarcation between engineering and production workers, whilst another specialised firm has highly job specific skills. Of the Finnish firms, some have very flexible working patterns to suit production needs (patterns which are reportedly also popular with workers). The systems in use enable workers to work up to seven days per week and extended hours when demand exists, and to be compensated with short weeks and shorter hours when there is no less demand. The flexibility of this system reduces labour costs by eliminating or reducing overtime payments. By contrast, some Finnish producers still retain outdated working practices due to union resistance to change.

### Social Costs of Labour

In the NIS firms, in addition to the statutory non-wage costs discussed in chapter 2, there are extensive systems of voluntary non-wage costs, arising from historical practices. These include, as well as pensions, holiday pay, and supplements for harmful working conditions, such payments as kindergarten and summer camp costs for the children of workers. However, due to the plight of the industry in both Belarus and Russia, these payments are not always being made. For example, in Belarus the social costs specified in the collective agreements are in some firms not being paid at all, or only partially. In Russia, due to the very vulnerable situation of some of the firms, the stipulated and agreed bonuses and voluntary social payments are not always being made. Most of the firms do, however, subsidise food and transport costs for their workers, with such subsidies accounting for 3-7% of the wage bill in the case study firms, although payment of these benefits is not always universal.

Figure 5.4 provides an example of the structure of labour costs in one Russian textile firm. It shows that overall labour costs represented 18.5% of total production costs. Of these the largest component was wages and bonuses paid directly to workers (accounting for 68.5 percent) and statutory social security payments took another 18.9%. Voluntary payments made up most of the balance.

**Table 4.4: Labour Costs in a Russian Textile Company**

Number of employees : 7111

Wages and bonuses (direct payments to workers)	68.5%
Social security deductions	18.9%
Social services (voluntary)	10.0%
On-the-job-training	0.5%
Safety	2.0%
Labour cost	100.00%

Labour cost/ Total cost = 18.5%

Source: *Russian case study*

The Finnish firms provide a comprehensive additional benefits package, including saunas and holiday entitlements, medical facilities, and sports facilities. The larger UK firms in the study provide a range of additional benefits, with, for example, one firm providing the following: company pension scheme, 33 days paid holiday, sickness benefits (full pay for six months), life insurance, subsidised canteen, medical check-ups, enhanced maternity and paternity benefits and enhanced redundancy benefits. The smaller UK firms tend to provide a more limited range of benefits.

#### Wage Determination

The influence of the trade unions in determining wages varies markedly across the four countries. In the NIS industries, trade union influence is very weak, with only formal or no involvement in determining wages. Collective agreements exist, but they are largely or entirely administrative exercises, and the benefits stipulated in the agreements are frequently not paid. There are no free trade unions in the Belarusan firms. In the Russian firms, wages are determined solely by the management. In Finland, the influence of the trade unions is stronger than in the other three countries, although this influence appears to be waning somewhat following the movement of production units abroad to lower cost countries. In the UK the influence of the unions is relatively weak, partly due to the highly competitive nature of the industry and its largely unorganised female workforce.

Most of the EU firms have pay systems which, in part, reward productivity. In Belarus there was no evidence of such systems. The Russian firms have either very simple systems, or none at all, although in some cases the firm is not able to implement the bonus system which exists due to its financial situation. For example, one firm has a bonus system which it cannot implement due to its precarious financial position and ageing equipment. Another company said it does not have the resources to implement productivity stimulating bonuses. Given that the NIS producers are unable to shed surplus labour, and do not have the resources to install new technology, they would appear to have relatively little incentive for introducing productivity enhancing schemes at present. In the case of one Russian firm, however, some attention has been given to encouraging quality work by means of penalising staff for low quality work by reducing wages.

The Finnish firms almost all have some form of Performance Related Pay scheme, accounting for up to 50 percent of pay in one case. Another firm however said it was unable to introduce performance related pay due to the “jealous work atmosphere”. In the UK firms, it was common practice to have PRP systems which accounted for about one third of total wages.

#### Legislative Pressures

With regard to labour legislation, whilst a statutory minimum wage exists in three of the countries (UK being the exception), it is effectively irrelevant in the NIS firms, because it is well below subsistence level and below the wages paid even in this low paying industry. In Finland, the minimum wage is of some relevance in that the rate of increase in minimum wages has traditionally been higher than the normal wage increase. In the UK the potential introduction of a statutory minimum wage may impact on the competitiveness of some firms. For example, one case study firm indicated that it is able to compete within the EU with other EU firms on the basis of lower labour costs, assisted by the absence of a minimum wage.

Health and safety standards in the four countries showed a marked divide between the EU and the NIS firms. Whilst health and safety legislation exists in both NIS countries, it is not given priority and is widely disregarded. In Russia the standards are low and hence cost little to meet, a situation encouraged by low levels of enforcement. Companies do not have the resources to meet even the low standards set. In contrast, the EU producers face much higher health and safety standards which cost much more to meet and are generally quite rigorously enforced. A common concern of the UK firms is keeping abreast of the regulations, with one large firm employing two specialists, and another, smaller firm feeling that there are too many regulations making it difficult to keep track of them. In Finland, one firm did highlight health and safety as being a problem, in that its air conditioning system is obsolete, and is a source of friction with workers and local health and safety authorities. This firm however appears to be the exception amongst the Finnish firms.

Environmental standards in the NIS countries and their enforcement show a similar situation to that on health and safety. Standards are low, cost little to meet, are widely flouted, and enforcement is lax. Environmental concerns are not yet on the agendas of firms in this industry. The EU producers on the other hand face much higher standards, which cost much more to meet and are enforced. The Finnish firms in particular are using their very high environmental standards (in excess of EU requirements) as a positive marketing advantage. In the UK, several firms mentioned the high cost of meeting environmental standards, particularly effluent charges. One, which had recently installed a new £100,000 plant to cope with emissions, anticipates that the current standards will be raised and this may present a problem in competing with imports from outside the EU.

#### Future Expectations

Future expectations vary considerably among the case study firms across the four countries, with the EU producers mainly feeling confident about the future, albeit with some concern about low cost imports, or the possibility of production being moved abroad to lower cost countries. The EU firms are mainly facing the challenge of the future by increased technology, further specialisation in new products and by quality upgrading.

In contrast, the textile firms in the NIS face different and potentially more serious problems. The way forward for the Belarusian firms appears to be large scale foreign investment in new technology and automation. However, this is unlikely to happen in the foreseeable future, due to the uncertain political and economic future. The Russian industry appears to be in an even more difficult situation, and the same comments about investment apply.

In Belarus, the best prospects appear to be for the company which produces linen, since flax is grown in Belarus. Those companies which are dependent on imported supplies of cotton face the most uncertain future. The industry organisation is currently negotiating with a foreign conglomerate and negotiations are also underway with a number of foreign companies to develop assistance packages. Conversion to joint stock companies may assist the future of the industry as a whole and of the case study firms, but this is still some way off. Capacity utilisation in the industry is currently less than 50%, and the situation in 1997 is not likely to improve, with a fall in the volume of production of 3-8% anticipated.

The expectations of the Russian case study firms are if anything more pessimistic than those of the Belarusian companies, with very similar problems being experienced.

In Finland, most firms anticipate that their competitiveness will remain unchanged in the future, with increasing development of specialisation, increased productivity and increasing exports. The only firm which feared that its competitiveness would be compromised in the future, felt that this was due to their outdated automation. Another felt that ageing machinery would be compensated for by greater productivity, thus leaving competitiveness unchanged. Of the other firms envisaging a good competitive future, emphasis was laid on the development of co-operative arrangements with other firms outside Finland. One firm is investigating the possibility of developing arrangements with an agent to sell clothing as well as fabrics to other EU countries. The EU as well as the USA were mentioned as being areas for future export development, with the EU being the main target. One firm which produces highly specialised fabrics, has started R&D work with large electrical firms to develop and produce a special type of fabric which neutralises static electricity, and expectations are high.

The reduction in EU weaving capacity was specifically mentioned as being a threat to the Finnish textile industry. The large weaving mills in the EU are so large that a 10 percent reduction in capacity in one such mill equals the whole capacity of one Finnish plant. Hard price competition is felt to be inevitable. However, the Finnish firms appear to be well placed to meet the challenge of the future, even though some of them have need of more modern technology and automation to ensure success. The

future appears to lie with increased specialisation, with the development of new and more highly specialised products, and with concentration on the quality conscious and environmentally aware markets of the EU and USA.

In the United Kingdom, firms' expectations of the future were highly varied. One firm (which produces a low-tech product and competes on costs) feels that it faces an uncertain future. It sells initially all of its output to another firm within the group, the multinational character of which could lead to a switch of production to a developing country. Another firm is not interested in growth, but is concerned to maintain its current largely UK customer base and embryonic export market. This firm is also concerned for the future, and in particular about possible increases in costs arising from pressure on wages and from higher environmental standards. This company is also facing capacity constraints on its current site, and is looking at the acquisition of new technology to overcome this.

#### Overview

Textile firms in Belarus and Russia are clearly in a more vulnerable position than those in the two EU countries studied. Their low labour costs are counteracted by low productivity and their low quality, unspecialised products are unlikely to pose a serious threat to the EU producers in the foreseeable future, unless large-scale foreign investment is secured. In the case of Belarus in particular, this seems unlikely. Although among the EU firms labour costs are significantly lower than those of the NIS producers, this is counteracted by higher productivity and greater quality control. Concentration on specialised high quality products suggests that Finnish and UK producers will meet any competition from NIS countries in the short to medium term. Higher labour standards in the EU than in the NIS do not currently appear to be a major factor affecting competition.

## **Policy Issues**

For the most part, textile firms in the NIS are in a more vulnerable situation than their EU counterparts, with falling domestic demand in Russia and severe raw materials difficulties in Belarus typifying the problems. Lower labour costs in the NIS firms are counteracted by poor productivity and quality issues. Finnish and UK firms also feel vulnerable in a world market, but most have challenged this by developing higher quality, niche products. Higher labour standards in the EU does not currently represent a major factor affecting the competitive position of firms compared to those in the NIS.

There is a range of influences that affect the competitive position of firms in the EU alongside NIS producers. Labour market structures can inhibit firms in doing what they wish to do to maximise productivity and this is the case in Finland as well as in Belarus and Russia, but less so in the UK where legislation is less comprehensive and the social dialogue less prescribed. However, the provision of an adequate legislative framework in such areas as health and safety at work may impose significant costs on firms, but could also have beneficial effects on productivity. The extent of non-wage costs in the four countries studied here vary from high in Finland to the lowest in the UK. The tradition of supporting employees is breaking down in the NIS and this will have the effect of reducing non-wage costs for firms, but at the same time wage costs are set to increase.

Convergence towards an EU approach to these matters is therefore observable in the NIS countries, but the process is extremely slow in Belarus and seriously inhibited in Russia. Issues likely to occupy firms in all four countries in the future include the cost of meeting environmental measures, where many firms in Finland in particular felt that they had much higher costs to contend with. In the UK there was some concern in the textiles sector over the effect of the introduction of a national minimum wage, given the generally low levels of pay in this sector among all four countries.

The study isolates a number of key issues that could provide a focus for attention by the EU in its dealing with industry within and outside the Union. These are as follows: Statistics; Informal sector; Social dialogue; Products and marketing; Import restrictions; and Labour standards generally.

### **Key Issues for International Competitiveness**

The demographic and labour market backdrop strongly influences international competitiveness from a number of perspectives. Firstly the general availability of labour will be reflected in its cost (wage) to an employer so that in the generally tighter labour markets of the EU Member States, the cost of labour will be higher than in the countries of the NIS. This, of course, is a simplistic interpretation of a more complex issue. There is unlikely to be a *national* labour market for most occupational groups and there will tend to be strong *sectoral* tendencies. This is illustrated by the evidence in this report .

The availability of appropriate labour and its price will be a key determinant of the decision of industry to invest in capital equipment, particularly in those sectors such as textiles, where there are reasonable alternatives in the methods of production. For example, it might be more rational for a producer in Russia (assuming that investment is an option) to defer investment in new equipment in the knowledge that the older, more labour intensive equipment will still meet the needs of the customer, albeit at a slower rate of output. However, speed of output may not be the dominant measure of productivity in the transitional states (as it tends to be in the EU producers), when labour can be used cheaply but not just because of low levels of wage, but also due to a lack of attention to such matters as health and safety which have the effect of increasing production costs, if adhered to.

However, it is clear from the case study firms that wages in Belarus and to a lesser extent Russia are artificially depressed at the moment. There are signs that in some sectors bonus systems have developed which aim to reward effort, but they tend to be poorly targeted and in some cases set at too high a proportion of income (50 per cent or more) that they act as a disincentive to the majority of the workforce that do not meet the demanding targets set. In the EU Member States, while there has been a significant spread of pay systems based on individual or team performance, they are normally at a proportion of income that enables firms to maintain the balance between incentive and disincentive.

The prevalence of the informal sector distorts these and most other comparisons that are attempted between the EU and the NIS countries. It is acknowledged to be very significant in Russia and Belarus and has flourished along with the liberalisation process. The problem is that such an important informal sector will serve to distort the labour market, affecting fundamental parts of it such as wage differentials based on the acquisition of skills and experience and simple job choices. It provides firms with some real difficulties in competing effectively since the competitor is often operating in the informal sector, thus escaping from the range of legislative and operational constraints that apply to the legitimate businesses. In the textiles sector there is a tradition of informal working which is often linked to sourcing the needs of businesses in the formal sector. Of course this kind of activity does go on in the Member States of the EU, but its extent in Finland and the UK is thought to be sufficiently small as to not distort the legitimate economy.

The whole issue of informal working does raise the issue of the extent of unemployment and under-employment in the countries studied. As discussed in Chapter 3, the differences in measuring unemployment between the EU Member States and the NIS countries effectively rules out meaningful statistical comparisons, though it is evident that the official figures on unemployment in Belarus and Russia significantly understate the true extent of the problem. High levels of hidden unemployment and underemployment in firms in the NIS countries, coupled with growing levels of unpaid layoffs (euphemistically called 'forced vacations') means that national labour resources are not being used effectively. From a competitive perspective it means that firms in Belarus and Russia are at a disadvantage when it comes to adjusting their workforce in the most productive manner. In Belarus, for example, firms have been encouraged to take on labour whilst output has been falling.

In Russia the situation is only slightly better in that firms are dissuaded from shedding surplus labour because of the punitive costs of redundancy.

Of course the price to pay for this freedom among firms to adjust their labour requirements is visible unemployment and the associated social and economic costs that come with it. Many firms in the UK have been through this adjustment process and have found it painful but ultimately beneficial (although the displaced workers might disagree). Productivity levels are generally comparatively high in the UK firms, while wage and non-wage employment costs are comparatively low (among the EU Member States). Unemployment is also comparatively low which is not the case in Finland, yet here too the firms studied had in the majority of cases gone through labour adjustment. However, wages are noticeably higher in Finland and the associated employment costs substantial when compared to the UK.

It is possible to identify some of the key competitive issues that emerged from the analysis:

- Labour costs are more significant as a proportion of total production costs in the NIS firms than in their EU counterparts;
- Significant job losses and openness to worldwide competition (with a close association between the two factors) common to all four countries;
- EU producers moving to quality products and niche markets to stave off competition. NIS producers not seen as threatening.

One issue relates to standards on health and safety at work where the divergence between the EU firms and the NIS firms is quite marked. It is often assumed by employers that a greater degree of attention to these issues poses a financial burden on the firm with consequent extra costs that will ultimately contribute to a worsening competitive position. However, the argument is advanced that instigating appropriate health and safety practices, while imposing extra costs, will eventually contribute to increased productivity through such factors as reduced absence from work.

### The Future

There are signs that labour markets and employer practices are moving towards the EU 'model', though the process is extremely slow in Belarus and seriously inhibited in Russia. However, it is difficult to conceive a clear idea of this EU model when there is still so much difference in approach between Member States, as amply illustrated by the labour markets in Finland and the UK. It is too misleading to consider that EU labour markets are converging, although it is reasonable to consider that certain aspects of their operation show increasingly similarity. This emerges in the case studies, with the development of outsourcing and performance related pay elements as clear indications of employers in Finland and the UK adopting similar approaches. On this basis, labour markets in Belarus and Russia are also moving in the general direction of the EU, although it is obvious that there are still too many

impediments to expect them to achieve even partial convergence within the next five or more years.

One particular area of legislation that is likely to figure prominently in the medium to longer term is that relating to the environment. Firms in Finland and the UK raised this as an important factor in their cost structure and one that was becoming increasingly demanding of resources. There was clearly some frustration amongst EU producers at the cost advantages enjoyed by NIS firms in the lack of comparable legislation and enforcement.

Greater attention to environmental matters will demand more capital investment from firms and this was recognised by case studies in all four countries. However, the EU firms had clearly a head start in terms of the quality and relevance of their equipment including that needed for environmental controls. Furthermore, the EU firms were generally committed to maintaining an investment programme that would ensure a head start over their NIS counterparts would remain.

However, EU firms did not feel immune to change and there was real concern in some of the UK textile firms, for example, that the adoption of a minimum wage would seriously dent their comparative advantage with producers within the EU and externally (though not specifically with the NIS firms). Significant job losses would appear to be the likeliest scenario for the future affecting labour markets in all four countries and across the three sectors, as all push for improved productivity and competitive advantage.

#### Issues for the European Union

From this study of labour standards and international competitiveness it is possible to isolate a number of key issues that could provide a focus for future policy in the EU. The issues discussed below are in no particular order and offer no solutions. Rather they are intended to stimulate debate about the future competitiveness of EU industry arising from its relations with the NIS.

#### Statistics

The serious problems with the comparability of economic, social and labour market statistics represents a serious threat to understanding the scale of any potential threat to the EU from the NIS. Some efforts have been made to bring statistics in the transitional states in line with international recommendations and practices, but the rate and scale of the improvements has not been encouraging.

#### Informal Sector

The effects of the informal sector are demonstrably substantial in the NIS. However, there is a lack of understanding of its scale and features and the effects, both real and potential, on employers in the legitimate economy.

### Social Dialogue

Effective social dialogue is in its infancy in the NIS with independent trade unions and employers' associations only emerging slowly. Social partner involvement in the development of industry must be considered a prerequisite for firms and employees alike and the considerable, though varied experience of the EU Member States provides a good basis for advice.

### Products and Marketing

The degree to which firms in the transitional states represent serious competition for EU firms will vary between sectors. The nature of the product is important here (its bulk and ease of transportation, for example) and the proximity of NIS producers to EU markets. This makes Member States sharing borders with NIS countries (and CEE countries) particularly vulnerable and demanding special attention.

### Import Restrictions

In some sectors the prevalence of EU import restrictions is considered highly protective and their removal threatens the existence of some EU producers.

### Labour Standards

The threat posed by the relatively high labour standards and their contribution to labour costs in the EU is, for the most part, illusory. High standards in such areas as health and safety bring associated benefits which are not currently enjoyed by most NIS firms. Greater flexibility in pay and conditions allows EU firms to adjust production as required and encourage increased productivity.

The above issues provide a focus for assistance projects such as TACIS and PHARE, as well as indicating the kinds of support EU firms might need in the longer term as markets are inevitably opened up and competition intensifies.

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**FOOTNOTES**

- <sup>1</sup> The Tacis Programme is an EU initiative in the NIS and Mongolia which fosters the development of harmonious and prosperous economic and political links between the EU and these partner countries. Its aim is to support the partner countries' initiatives to develop societies based on political freedoms and economic prosperity. ACE represents a focused strand of the programme covering Action for Co-operation in the Field of Economics.
  
- <sup>2</sup> Trade union membership density is the ratio of total membership to potential membership, the latter including only those groups eligible to become union members (which normally excludes those unemployed, for example).
  
- <sup>3</sup> These codes of practice are not legally enforceable but can be used in evidence in the law (such as during an industrial tribunal).

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