LABOR AND MIGRATION IN THE EUROMEDITERRANEAN REGION :

Issues and Perspectives

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This work is based on the Working package WP3- Go-Euromed Project, 2007

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INTRODUCTION

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A way to introduce this book is to observe some striking facts about the unemployment rate figures in the European and the American continents.

In general, the unemployment figures appear to be higher in the region composed of the North, South, and East Mediterranean countries in comparison with the rates that prevail on the American continent. In this latter region, the unemployment rates for domestic workers are slightly higher than those of foreigners. Male foreigners appear to be less unemployed than their national counterparts, while the opposite is observed for female workers. The situation is completely opposite in European countries and the Mediterranean region where foreigners have definitely the highest unemployment rates (in total and by gender) relative to national workers. Tables 1 and 2 provide data that support the above evidence.

Table 1: Extra-European differences in unemployment rates between foreigners and nationals

Country	Unemployment rate of nationals (men)	Unemployment rate of foreigners (men)	Unemployment rate of nationals (women)	Unemployment rate of foreigners (women)
Canada	10.3	9.9	9.5	11.6
USA	4.9	4.4	4.1	5.6
Australia	6.7	6.6	5.8	6.9

Source: **Bureau International du Travail**: *Une approche équitable pour les travailleurs migrants dans une économie mondialisée*, Conférence Internationale du Travail, 92ème session, Publications du BIT, Genève, 2004, 2000-2001 figures

Table 2: European differences in unemployment rates between foreigners and nationals

Country	Unemployment rate of nationals (men)	Unemployment rate of foreigners (men)	Unemployment rate of nationals (women)	Unemployment rate of foreigners (women)
Germany	7.2	13.4	7.8	11.7
France	7.1	17.1	10.7	23.9
United Kingdom	5.5	16.1	4.4	7.9

Source: **Bureau International du Travail**: *Une approche équitable pour les travailleurs migrants dans une économie mondialisée*, Conférence Internationale du Travail, 92ème session, Publications du BIT, Genève, 2004, 2000-2001 figures

In Europe, there is higher unemployment where the vulnerable segments are mainly composed of foreign workers. This situation does not exist in the American continent.

Furthermore, it appears that Mexico and the United States, although they have low similar and non-differentiated (foreign versus nationals) unemployment rates, have difficulties pursuing their negotiations on a migratory agreement. With this in mind, there might be some prior pessimistic view about the perspectives for labor and employment cooperation between the European zone and the Mediterranean basin. But, the issues of labor and migration are fundamental questions in the partnership and cooperation between Europe and the Mediterranean countries, so specific investigations can be undertaken to understand the directions and extent of generating win-win solutions to enhance the levels of cooperation also in the area of labor and migration.

The following directions of investigations help address the contours of some basic questions that are likely to be providing sources of explanations:

a) **The capacity of European economies to create jobs relative to the other world economies:** It is worthwhile investigating the nature of labour markets in Europe and test for the eventual existence of less structural employment in comparison with the American labor markets. Are there some institutional structures and methods that can promote job creation in a more successful way? This will help understand the possibilities or impossibilities of job creation and unemployment in Europe relative to other countries. Furthermore, migration from the South in relation to labor markets in the North can be better understood within this explanatory framework.

b) **What are the factors that can explain the incapacity of Southern Mediterranean economies to generate more jobs and reduce the demand for labor emigration?** Moreover, it is important to identify the factors that are behind the incapacity of the Southern Mediterranean economies to create on their own the jobs necessary for the reduction of their unemployment rates. This will certainly help understand some sources of the migration flows that are targeting Europe.

c) **How can the above explanations account for skilled versus unskilled labor?** In addition, it is probable today that the economies of the North no longer have need for unqualified workers (the economies of the North preferring to satisfy their need for unqualified, labour-intensive goods by importing them and even by delocalizing certain service activities such as call centres to low-wage countries). The needs of industrialized countries are, thus, more oriented toward highly qualified workers. It may be feared then that this form of immigration could represent a 'brain drain' detrimental to the economies of the South. The issues of the migration of highly qualified workers are therefore a crucial aspect of the analysis.

d) **How can agricultural liberalization be another explanatory factor?** Agriculture is another key factor to understand internal and international migration. In many Southern Mediterranean countries, the employment in agriculture, as a percentage of total employment, remains high. The liberalization and modernization of agriculture in these countries are probably going to release an important share of the rural labor force that is going to migrate to the cities and/or to the Northern countries. Macroeconomic policies that could be biased against agriculture besides different sources of agricultural and environmental risks (climatic changes) do also contribute to the increase of outward migration.

e) **How can social dumping be another source for understanding migration?** Finally, the difference of labor standards in the North and in the South is raising the issue of the so-called "social dumping", where Northern countries fear the competition of Southern economies that have less protective standards. This means that the overall explanation should account for the legal environment of the relation between the European Union and its Mediterranean partners. For this purpose, comparisons with Mexico and the United States are important. This approach can be used, for example, to discuss the opportunity of introducing a "social clause" in the Euro-Mediterranean partnership.

These are the issues treated in this book that is the result of the contributions of the team composed of researchers from France, Morocco, Romania, Spain, and Turkey, with the financial support of the European Commission[1]. The first part of the book deals with the major theoretical issues regarding migration, that is to say, the problem of the "Brain Drain" on the one hand and the consequences of the liberalization of agriculture on the other hand. The second part is a reflection on the functioning of labor markets both in the European Union and in the South and East Mediterranean Countries (SEMC). The third part deals with the problem of social dumping, and the question of the possibility that the "Polish plumber fear" could extend to "Tunisian workers". It also deals with the "social clause" device, with a study of the North American Free Trade Agreement (NAFTA) experience, and more precisely the "Labor Side Agreement" negotiated between Mexico, Canada, and the United States.

[1] European research contract n° 028386 named « The Political Economy of Governance in the Euro-Mediterranean Partnership » (Go-EuroMed), Sixth Framework Programme.

PART ONE: THEORETICAL ISSUES ON MIGRATION

CHAPTER 1: Agriculture Liberalization, Migration, and Taxes

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Agricultural liberalization obviously means a cut in taxes resources, but it also implies a change in the relative price of the agricultural good relatively to the manufactured good. So, it has at the same time consequences on the public budget equilibrium, and consequences on internal, as much as international, migration flows. In this chapter, we will use a simple Harris-Todaro model in order to demonstrate the incompatibility of various objectives such as agricultural liberalization, social clause, the control of South-North migration, political stability and budgetary equilibrium. In the first section we define the model, then in the second section we analyze the effects of several policies, and in the third section we focus on the intuitive interpretation and policy recommendations.

1.1: The Model

The model represents an economy producing two goods, one manufactured good and one agricultural good. The manufactured good can be produced in the formal sector or in the informal sector. The formal sector uses a fixed amount of capital and pays taxes. Besides, the formal sector is constrained by a real minimum wage. The informal sector is composed of small individual producers who share equally the real amount of activity of the sector. The entrepreneurs in the informal sector don't pay taxes, but they sell their product at the same price as the formal sector. The agricultural good is produced in the rural sector, which uses a fixed amount of capital, pays taxes, but is not constrained by the minimum wage, following the tradition of Harris-Todaro models.

The individuals are perfectly mobile between the three sectors, and they also have the possibility of emigrating without any costs and working in the foreign informal sector (we suppose here that all the emigration is illegal, so that the migrants will necessarily work in the informal sector abroad). The foreign informal sector is supposed to have a fixed, real size, which is determined exogenously. As a consequence of these assumptions, the individuals have the choice between four situations:

- To work in the rural sector;
- To search for a job in the (urban) formal sector, without any other activity than the search;

- To work part-time in the informal sector and search at the same time for a formal job;
- To emigrate and work in the informal sector abroad.

The fundamental hypothesis is that the individuals are going to migrate between the four sectors until the equalization of expected income of the four sectors (rural, national formal, national informal and foreign informal). We suppose the individuals are risk-neutrals and we focus on the no-migration equilibria, i.e. the equilibria where the expected income is the same in all sectors.

We then use the following notations:

w_a: real wage in the agricultural sector.

w_u: real wage (fixed institutionally) in the urban sector. In fact, w_u is the real minimum wage. It is supposed that the real minimum wage is higher than the wage that equilibrates the formal urban labour market, so that there is urban unemployment.

Q_i: real size of the national informal sector

Q_e: real size of the foreign informal sector

q: probability to find a formal job for an individual while seeking full-time. For an individual working in the informal sector and searching a formal job at the same time, this probability is h.q, with h<1 (see Fields).

L_j, with j = a, i, e: population working respectively in the agricultural sector, informal national sector and foreign informal sector.

L_u: individuals seeking full-time an urban formal work or having such a work

E_u: individuals working in the urban formal sector, L_u-E_u represents the unemployed population

L: total population

P: general price level

p_u^p and p_a^p: the producer prices of the manufactured good and agricultural good

p_u^c and p_a^c: the consumer prices of the manufactured good and agricultural good

p_u^w and p_a^w: the world prices of the manufactured good and agricultural good

α: the part of agricultural products in the consumption basket

t_a and t_u: the sales taxes on the agricultural good and the manufactured good (only in the formal sector), d_a is the customs duty for the agricultural good. It is supposed that the customs duty is nil for the manufactured good.

The following equations define the model equilibrium:

$$w_a = P_a . f'(L_a) \qquad (1)^2$$
$$w_a = q . w_u \qquad (2)$$
$$w_a = h.q.w_u + (1-hq).Q_i / L_i . \qquad (3)$$
$$w_a = Q_e/L_e \qquad (4)$$
$$w_u = P_u . g'(E_u) \qquad (5)^3$$
$$q = E_u / (L_u+L_i.h) \qquad (6)$$

[2] we suppose f' > 0 and f''<0
[3] we suppose g' > 0 and g''<0

$$L_a+L_i+L_u+L_e = L \quad (7)$$
$$P_a = p_a^p / P \quad (8)$$
$$P_u = p_u^p / P \quad (9)$$
$$P = \alpha.\, p_a^c + (1-\alpha).\, p_u^c \quad (10)$$
$$p_a^c = (1+t_a).\, p_a^p \quad (11)$$
$$p_u^c = (1+t_u).\, p_u^p \quad (12)$$
$$p_a^c = (1+t_a).(1+d_a).\, p_a^w \quad (13)$$
$$p_u^c = (1+t_u).\, p_u^w \quad (14)$$
$$Q_i = a.t_u + b \quad (15)$$

Are *exogenous*: the functions f and g, the variables w_u, h, Q_e, L, α, p_a^w, p_u^w, t_a, d_a, t_u, a and b. Are *endogenous*: L_a, L_i, L_u, L_e, E_u, q, w_a, P, P_a, P_u, Q_i, p_a^p, p_a^c, p_u^p, p_u^c so that there are 15 endogenous variables.

Equations (1) and (5) result from the equality between nominal wage and the value of the marginal product in agricultural and manufactured formal sector. Equations (2), (3), and (4) mean that an equilibrium expected income is identical in all sectors. There are two populations looking for a formal work: one population, which size is L_u, has a probability q of finding it and the other population, which size is L_i, has a probability h.q. The mean probability for the two populations is E_u / (L_u+L_i), so that we can deduce of the total probability formula the equation (6). Equations (7) to (14) are accounting identities or definitions. Equation (15) means that the size of national informal sector is a linear function of t_u, which is the tax on manufactured good. Note that "a" can be positive or negative, which means that a rise in t_u can have a positive or a negative effect on Q_i. Q_i can also have an exogenous expansion, by changing the value of parameter « b ».

It can be proved that:

(2) and (3) imply:

$$L_i = \frac{Q_i}{(1-h).w_a} - \frac{Q_i.h}{(1-h).w_u} \quad (16)$$

And, from (2), (6), and (16), we deduce:

$$L_u = \frac{(1-\mathrm{h}).\mathrm{E_u} w_u - h.Q_i}{(1-h).w_a} + \frac{h^2.Q_i}{(1-h).w_u} \quad (17)$$

(4), (7), (16), and (17) imply:

$$L_a + [E_u.w_u + Q_i + Q_e] / [P_a.f'(L_a)] = [L+h.Q_i / w_u] \quad (18)$$

That is, if we note C the expression $[E_u.w_u + Q_i + Q_e]$ and D the expression $[L + h.Q_i/w_u]$:

$L_a + C / [P_a.f'(L_a)] = D$ or:

$C / P_a - F. f'(L_a) = 0$ with $F \equiv (D-L_a)$ (18')

It can be demonstrated that, in order to have $L_u > E_u$ (which means that there are some people unemployed), it is necessary and sufficient to have:

$$E_u . w_u > \frac{h}{(1-h)} . \frac{(1-hq)}{(1-q)} . Q_i \quad (19)$$

We will now analyse the case of an economy which liberalizes its agriculture. In this model, national agriculture is protected by a customs duty d_a and so the national rural sector is having the advantage of a producer price above the world price for the agricultural good. As a result, the labour force in the rural sector is important. So, when the liberalization takes place, the labour force will go from the countryside to the cities. But, from another point of view, the customs duty is a source of income for the government and so, in order to maintain fiscal equilibrium, it is necessary to raise the sales taxes. Thus, it is also necessary to study the consequences of an increase in taxes in order to analyse the effects of agricultural liberalization.

1.2: The Policies and Their Consequences

In this model, the main origin of the migration process is the liberalization of the agricultural sector, and, as long as fiscal equilibrium is an objective for the government, this liberalization may be accompanied by an increase in taxes to compensate for the shortage of fiscal resource. So, in this section, we will study the effects of a decrease in d_a and the effects of an increase in t_a and/or t_u. Our attention will be concentrated on the migratory consequences and we will study the compatibility of this liberalization policy with other objectives that a government may have.

1.21: Consequences of a decrease in d_a

It is possible to demonstrate the following result:

$dE_u / dd_a = (dE_u / dP).(dP / dp_a^c).(dp_a^c / dd_a)$ so that:

$E_u' (d_a) = [\alpha.w_u. p_a^w.(1+t_a)] / [p_u^p .g' '(E_u)] < 0.$ (20)

$dP_a / dd_a = (dP_a / dp_a^p).(dp_a^p /dd_a)$, so:

$dP_a / dd_a = [(1-\alpha).\ p_a^{w}\ .p_u^{c}] / P^2$, expression we will note « A », $A > 0$.
(21)

We can show by using equation (18') and the implicit function theorem that:

$$\frac{dL_a}{dd_a} = \frac{f'(L_a).F.A - w_u.E_u'(d_a)}{P_a.\left[f'(L_a) - f''(L_a).F\right]} > 0$$
(22)

It can also be shown that:

$$\frac{dw_a}{dd_a} = A.f'(L_a) + \frac{df'(L_a)}{dd_a}.P_a = A.f'(L_a) + f''(L_a).\frac{dL_a}{dd_a}.P_a$$

$$\frac{dw_a}{dd_a} = \frac{A.\left[f'(L_a)\right]^2 - f''(L_a).E_u'(d_a).w_u}{f'(L_a) - f''(L_a).F} > 0$$
(23)

if and only if:

$$A.\left[f'(L_a)\right]^2 > f''(L_a).E_u'(d_a).w_u$$

That is:

$$1 > \frac{1}{G(\alpha)} > \alpha \geq 0$$

$$with\ \ G(\alpha) \equiv 1 + \frac{P^2 f'' w_u^2 (1+t_a)}{(1+t_u).\ p_u^{w^2} f'^2 g''} > 1$$
(24)

when $\alpha = 0$ we get $\alpha.G(\alpha) = 0$ and when $\alpha = 1$, $\alpha.G(\alpha) = G(\alpha) > 1$. If we suppose that the function $H(\alpha) = \alpha.G(\alpha)$ is a continuous function monotonously increasing on [0, 1], there exists an $\alpha^* \in [0, 1]$ such that if $\alpha < \alpha^*$ (α « small»), condition (23) is satisfied, while if $\alpha > \alpha^*$ (α « big »), condition (23) is violated. In order to have $H(\alpha)$ increasing on [0, 1] it is necessary and sufficient that $H' = \alpha.G' + G > 0$, that means that the elasticity of G respectively to α must be superior to -1 ($G'>0$ or $G'<0$ but $|e_{G/\alpha}| < 1$).

In addition, we show that:
$dL_u/dd_a = 1/w_a^2\ .\ [\ E_u'\ (d_a).w_a.w_u + (hQ_i/(1-h) - E_u.w_u).\ dw_a/dd_a\ ]$
(25)

This expression is necessarily negative if dw_a/dd_a is positive, i.e. under condition of equation (24) (α small).
Moreover, $L_e = Q_e / w_a$ (equation 4) thus:

Sign (dL_e/dd_a) = - Sign (dw_a/dd_a).
In equation (16) all the parameters are independent of d_a, except w_a, thus:
Sign (dL_i/dd_a) = - Sign (dw_a/dd_a).
When α violates condition (24) (α big) then dL_i/dd_a, dL_e/dd_a, dL_a/dd_a are positive, then $d(L_i+L_e+L_a)/dd_a$ is positive, and dL_u/dd_a is negative (by virtue of (7)). It follows that, whatever is the value of α, dL_u/dd_a is negative.

In summary, if d_a decreases (liberalization of agriculture):

	L_a	L_i	L_e	L_u	E_u
α big	decreases	decreases	decreases	increases	increases
α small	decreases	increases	increases	increases	increases

When d_a decreases, internal (rural-urban) migration always increases (L_a always decreases, $L_u+L_i = L-(L_a+L_e)$ always increases). By contrast, international migration L_e can increase or decrease, depending on the value of α. When α is small, the liberalization has a positive effect on international migration, while it is the opposite when α is big. So we can say that trade and migration are complementary when α is small, while they are substitutable when α is big.

A last question is how does (Lu – Eu) (the number of unemployed people) change when d_a decreases?

We can show that:

$$\frac{d(L_u - E_u)}{dd_a} = \frac{\left[\frac{dE_u}{dd_a}.w_a.(w_u - w_a).(1-h)\right] + \left[\frac{dw_a}{dd_a}.\left[h.Q_i - (1-h).E_u.w_u\right]\right]}{(1-h).w_a^2} \qquad (26)$$

the first term of the numerator is necessarily negative, as $E_u'(d_a) < 0$ (cf. 20) while the second term may be positive or negative. That second term is composed of two factors. The first one, dw_a/dd_a may be positive or negative, depending on whether α is (respectively) small or big (cf. *supra* equations 23 and 24), and the second one is necessarily negative if condition (19) holds. It results that if dw_a/dd_a is positive (α small) L_u-E_u increases when d_a decreases, which means that agricultural liberalization increases the number of unemployed. When dw_a/dd_a is negative, expression (26) has in the numerator a negative and a positive term. Expression (26) may then be positive, if the second (positive) term is bigger than the first one.

In summary, we will have, if d_a decreases (liberalization of agriculture):

	L_a	L_i	L_e	L_u	L_u - E_u
α big	decreases	decreases	decreases	increases	?
α small	decreases	increases	increases	increases	increases

1.22: Consequences of an increase in t_a and t_u

Liberalization means a drop in the resources of the State, insofar as taxes on international trade are an important percentage of the resources of the State in several developing countries (see Table 1).

Table 1: Structure of central government revenues in 2001 for 9 developing countries and Mean Values for middle income economies (as a percentage of total current revenue)

Country	*Taxes on Income, profits and capital gains*	*Social Security Taxes*	*Taxes on goods and services*	*Taxes on International Trade*	*Other Taxes*	*Non tax Revenue*
Algeria	70	0	8	11	1	10
China	6	0	75	10	4	6
Egypt (1997)	22	0	17	13	12	37
India	29	0	29	18	0	24
Jordan	12	0	36	17	10	24
Mexico	34	10	62	4	1	10
Morocco	24	5	36	16	3	16
Tunisia	20	17	38	11	4	9
Turkey	35	0	40	1	7	17
Lower Middle Income countries (mean value)	20	3	36	9	3	14
Upper Middle Income countries (mean value)	17	31	37	3	1	10

Source: World Development Indicators 2004

Thus, it will be necessary to increase other taxes in order to compensate the reduction of resources coming from international trade. In this model, we examine the possibility of an increase in the sale taxes and the implications it will have on migrations.

A) Consequences of an increase in t_a.

dL_a/dt_a is given by equation (22) where we replace A by dP_a/dt_a and E_u' (d_a) by E_u' (t_a). In the same way, dw_a/dt_a is given by equation (23) where we replace A and E_u' (d_a) similarly. We also show that:
$dP_a/dt_a = - \alpha P_a^2 < 0$ and $dE_u/dt_a = [\alpha.p_a^p.w_u] / [p_u^p.g''(E_u)] < 0$

dL_a/dt_a can be negative or positive, but dw_a/dt_a is necessarily negative. Negativity of dw_a/dt_a implies positivity of dL_e/dt_a and dL_i/dt_a. That means that when we increase taxes on agricultural good, *ceteris paribus*, L_e and L_i also increase.

Moreover, it can be shown that:
Sign (dL_a/dt_a) = Sign $(C.\ p_u^P.\ g''(E_u) + w_u^2.\ P)$ with $C = [E_u.w_u + Q_i + Q_e]$

$g''(E_u)$ is by hypothesis negative so that the second expression has a negative term and a positive one. It is possible to demonstrate that a necessary and sufficient condition for dL_a / dt_a to be negative is:

$$Q_i + Q_e > - w_u.\ [E_u + g'(E_u)/g''(E_u)] \qquad (27)^4$$

The intuitive interpretation of that condition is easy: when taxes increase, formal employment decreases ($E_u'(t_a)$ negative). So, in order to have a decrease in the agricultural work force, i.e. to permit a rural-urban migration, the size of informal emigration sectors (both national and foreign) must be big enough to absorb the migratory flow and offer an income level high enough to be attractive.

In summary, when t_a increases:

	L_a	L_i	L_e	E_u	w_a
(27) hold	decreases	increases	increases	decreases	decreases
(27) doesn't hold	increases	increases	increases	decreases	decreases

We can also note that $d(L_u-E_u)/dt_a$ is given by equation (26) where we replace $E_u'(d_a)$ by $E_u'(t_a)$ and dw_a/dd_a by dw_a/dt_a. $E_u'(t_a)$ like $E_u'(d_a)$ is negative, but dw_a/dt_a is necessarily negative, while dw_a/dd_a may be positive or negative, depending on whether α is (respectively) small or big. As a consequence we cannot say in the general case if $d(L_u-E_u)/dt_a$ is positive or negative.

B) Consequences of an increase in t_u

It can be shown that:
$dP_a / dt_u = -[p_a^P.\ p_u^P.\ (1-\alpha)] / P^2 < 0$. We will call this expression X.
$dE_u / dt_u = [(1-\alpha).w_u] / [g''(E_u)] < 0$. We will call this expression Y.

Using (18') and the implicit function theorem, we demonstrate that:

$$\frac{dL_a}{dt_u} = \frac{a.h.f'(L_a)}{w_u.[f'(L_a) - f''(L_a).F]} + \frac{F.f'(L_a).X - w_u.Y - a}{P_a.[f'(L_a) - f''(L_a).F]} \qquad (28)$$

This expression is strictly negative, if and only if:

[4] note that a sufficient, but not necessary, condition of (27) is: $E_u > - g'(E_u) / g''(E_u)$, i.e. function $g'(E_u)$ must have an elasticity relatively to E_u inferior to -1 (superior to one in absolute value). Condition (27) may also be rewritten $C / w_u > -g'(E_u) / g''(E_u)$, or $F.q > -g'(E_u) / g''(E_u)$.

$$a > \frac{Y.w_u - X.F.f'(L_a)}{h.q-1} = a_1$$ [5]

(29)

By replacing X and Y with their value, one gets:

$$C.\ p_u^p.\ g''(E_u) + w_u^2.\ P < Z$$

(30)

with $$Z \equiv a.\ \frac{P.(h.q-1).g''(E_u)}{(1-\alpha)}$$

In the general case, it can be shown that the negativity condition is:

$$Q_i(t_u) + Q_e > \frac{Z}{p_u^p.g''(E_u)} - w_u.\left({g'(E_u)}\Big/{g''(E_u)} + E_u \right)$$

(31)

This condition looks like condition (27) and is equivalent to (27) when a=0 (i.e. when Q_i does not depend on t_u). When a is positive, Z is also positive and the right half of (31) is smaller (g''<0) than the right half of (27): equation (31) may be satisfied even if (27) doesn't hold. This means that when Q_i depends positively on t_u it is more frequent to have an increase of t_u, creating a rural-urban migration.

It can be also shown, thanks to equation (1), that:

$$\frac{dw_a}{dt_u} = X.f'(L_a) + f''(L_a).\ P_a.\frac{dL_a}{dt_u}$$

(32)

By replacing dL_a/dt_u by its value we obtain:

$$\frac{dw_a}{dt_u} = \frac{X.f'(L_a)^2 + f''(L_a).\left[a.(hq-1) - w_u.Y\right]}{f'(L_a) - f''(L_a).F}$$

(33)

This is strictly positive if and only if:

$$a > \frac{X.f'(L_a)^2 - f''(L_a).w_u.Y}{f''(L_a).(1-h.q)} = a_2 \geq 0$$

(34)

We demonstrate now that $a_2 \geq a_1$:

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[5] a_1 may be positive or negative. Condition (27) is necessary and sufficient to have a_1 negative. When (27) holds, (29) is satisfied for any « a » superior or equal to zero and so dL_a/dt_u is always strictly negative.

Let us suppose the contrary:
$a_1 > a_2$ implies $f''(L_a). F > f'(L_a)$, but this is impossible as: $f'(L_a) \geq 0 \geq f''(L_a). F$.

It is a consequence of (4) that $L_e = Q_e / w_a$, with Q_e exogenous. As a result we have:
Sign (dL_e / dt_u) = - Sign (dw_a / dt_u)

In summary:

Value of a	$a < a_1$	$a_1 < a < a_2$	$a_2 < a$
Sign of (dL_a / dt_u)	+	-	-
Sign of (dw_a / dt_u)	-	-	+
Sign of (dL_e / dt_u)	+	+	-

We also know by (16) that:

$$L_i = \frac{Q_i}{(1-h).w_a} - \frac{Q_i.h}{(1-h).w_u}$$

so $$\frac{dL_i}{dt_u} = \frac{a.w_a.(1-hq) - Q_i.\dfrac{dw_a}{dt_u}}{(1-h).\ w_a^{\ 2}} \qquad (35)$$

which is strictly positive if and only if:

$$a.w_a.(1-hq) - Q_i.\frac{dw_a}{dt_u} > 0.$$

But we know by (33) that:

$$\frac{f''(L_a).a.(hq-1)}{f'(L_a) - f''(L_a).F} > \frac{dw_a}{dt_u} \qquad (36)$$

and so:

$$a.w_a.(1-hq) - Q_i.\frac{dw_a}{dt_u} > \frac{a.(1-hq).[w_a.f'(L_a) + (Q_i - C).f''(L_a)]}{f'(L_a) - f''(L_a).F} \geq 0 \qquad (37)$$

and so we have shown that $\frac{dL_i}{dt_u} > 0$.

In summary, when t_u increases:

	L_a	L_i	L_e	E_u	w_a
$a < a_1$	increases	increases	increases	decreases	decreases
$a_1 < a < a_2$	decreases	increases	increases	decreases	decreases
$0 \leq a_2 < a$	decreases	increases	decreases	decreases	increases

We can also note that d $(L_u\text{-}E_u)/dt_u$ is given by the second half of equation (26) where we replace E_u' (d_a) by E_u' (t_u) and dw_a/dd_a by dw_a/dt_u and to which we add a positive expression equal to $[a.h^2/ (1\text{-}h).w_u]$.

E_u' (t_u) like E_u' (d_a) is negative, and dw_a/dt_u may be positive or negative, depending on whether "a" is (respectively) superior or inferior to a_2. As in the former case, the sign of d $(L_u\text{-}E_u)/dt_u$ can be positive or negative.

1.23: Synthesis

Let us analyze now the global effects of a decrease in d_a financed by an increase in t_a or t_u.

Case 1: A decrease in d_a financed by an increase in t_a

	L_a	L_i	L_e	E_u
α big, (27) satisfied « zone 1 »	decreases	?	?	?
α big, (27) not satisfied « zone 2 »	?	?	?	?
α small, (27) satisfied « zone 3 »	decreases	increases	increases	?
α small, (27) not satisfied « zone 4 »	?	increases	increases	?

The undetermined cases are due to the fact that the two effects act contradictorily. However, when α is small we always see an increase of L_i and L_e, as well as a decrease in L_a whatever value α is when (27) holds.

Case 2: A decrease in d_a financed by an increase in t_u

	L_a	L_i	L_e	E_u
$a<a_1$, α big	?	?	?	?

a_1<a<a_2, α big	decreases	?	?	?
a_2<a, α big	decreases	?	decreases	?
a<a_1, α small	?	increases	increases	?
a_1<a<a_2, α small	decreases	increases	increases	?
a_2<a, α small	decreases	increases	?	?

Here we insist on the value of α and that of "a". Each time a>a_1, the combined actions produce an increase in rural-urban migration. When α is small, the two actions always increase employment in informal sector. Besides, international migration necessarily increases for "small α countries", as long as "a" is not too big (i.e., when a<a_2). As a matter of fact, when "a" is very high, that means that the national informal sector activity grows a lot as a result of an increase in taxes, and in consequence that sector is going to absorb the flow of migrants coming from the rural sector. Similarly, it is clear that "big α countries" with a big value of "a" (a>a_2) will experience a decrease in international migration in the case we are studying.

1.3: Intuitive Interpretation and Policy Recommendations

In this section, we will give an intuitive interpretation of the results we have seen. We will also give some policy recommendations in order to illustrate what one can learn from a Harris-Todaro model like this one. Furthermore, we also provide an annex containing the value of α, i.e. food expenditure as a percentage of total expenditure, for some countries. It is possible to see that Southern Mediterranean countries, with the exception maybe of Tunisia, have relatively high values of α, while countries with low values of α are mostly developed economies, or East-European and Latin-American ones.

1.31: Intuitive functioning of the model

A) The effect of a decrease in customs duties (d_a)

The value of α affects the relation between agricultural liberalization and migrations by virtue of the following scenario:

Case 1*: If alpha is big (at the limit, workers are uniquely paid in agricultural goods)*

- The cutting down of agricultural custom duties generates a drop in domestic agricultural prices, which provokes a rise in urban employment, this rise being stronger when agricultural goods have a bigger part in the consumption basket ;

- If rural population (L_a) were set constant, rural real wage (w_a) would not decrease much , as P_a does not change a lot if α is close to one ;
- But the rise in urban employment increases the expected value of urban income, and that provokes an increase in rural-urban migration (L_a decreases);
- The decrease of L_a generates an increase of w_a, which reduces international emigration and emigration to national informal sector.

Case 2: If alpha is small (at the limit, workers are uniquely paid in manufactured goods)

- The drop in agricultural customs duties only moderately increases urban employment as the workers do not consume much agricultural goods;
- With a constant L_a, rural real wage (w_a) decreases a lot, because the price of the agricultural good lowers and the workers consume essentially manufactured goods;
- The fall in w_a together with the quasi-stagnation of urban formal employment increases the migratory pressure toward national and foreign informal sectors.

The difference between the two cases is intuitively that:

- In the first case (α is big), the increase in urban formal employment is big enough to absorb the migratory flow coming from the rural sector while in the second case (α is small), the expansion of urban formal sector is not big enough;
- In the first case, the domestic drop in agricultural prices does not decrease real wages much in the rural sector because the workers only consume the agricultural good they produce. In this case migratory pressure does not come from the worsening of rural situation, but from the improvement of the urban formal employment. The improvement of the urban formal employment generates positive effects on the rural sector and a decrease of informal employment, both foreign and national.
- By contrast, in the second case (α is small), the workers produce an agricultural good whose price is lowering and consume essentially manufactured goods whose price is constant. The deterioration of internal terms of exchange (ratio of agricultural prices to manufactured prices) generates a decrease in real wages in the rural sector. On the opposite side, the urban formal sector does not experiment a notable expansion. The rural-urban migration is in this case the consequence of a deterioration of rural situation. As formal urban employment did not increase, that means an increase in foreign and national informal employment.

B) The effect of an increase in taxes

It is important to make the difference between the case of an increase in taxes that affect the agricultural good and the case of a growth of the taxes that bear on the manufactured good. As a matter of fact, in the second case, the fiscal increase will have an expansive effect on the national informal sector, which will develop itself at the expense of the formal sector, while in the first case this effect will not appear.

Case 1: An increase in t_a

In order to have an increase in t_a implying a decrease in rural employment, it is necessary and sufficient to have condition (C) satisfied, as demonstrated above (see equation 27):

(C): $Q_i + Q_e > \phi(E_u)$, where Q_i is the size of the national informal sector, Q_e is the size of foreign informal sector (emigration sector), and E_u is urban formal employment.

This condition means that an increase in agricultural taxes will not have a negative effect on rural employment unless the sum of the sizes of the foreign and national informal sectors is big enough. As a matter of fact, the increase in agricultural taxes generates an increase in wage costs and consequently a decrease in urban formal employment. It is thus necessary to have the informal sectors big enough to explain that the rural workers leave the countryside.

Case 2: An increase in t_u

In this case, Q_i is no longer exogenous as it varies in function of t_u (when t_u increases, Q_i also increases). If we want to have L_a decreasing in response to an increase in t_u, it is necessary and sufficient to have Q_i “sufficiently” sensitive to the variation in t_u (in order to have (C) satisfied). So it is necessary to have "a" (i.e. dQ_i /dt_u) “sufficiently” big in order to have the increase in t_u provoking a decrease in L_a (rural employment). That explains the condition: $a > a_1$.

If we are interested in the evolution of international migration, the important point is the effect of the increase in t_u on the real agricultural wage w_a. This effect takes place by two channels: on one hand, the effect of t_u on the general price level and, on the other hand, the effect of t_u on rural employment L_a *via* its effect on Q_i (cf. supra). We demonstrate that when $a < a_2$ the sign of dw_a/dt_u is negative. As we have set that $L_e = Q_e/ w_a$, we can deduce that when $a < a_2$, L_e increases if t_u increases (and inversely if $a > a_2$).

1.32: Policy recommendations

In order to make policy recommendations, we first will identify some goals that can be pursued by governments. A first goal could be political stability which can signify for the country of origin of emigration (let us say, the South) a low level of urban unemployment. Another objective could be as we have said budgetary equilibrium, so that a reduction in customs duties must be balanced by an increase in other taxes, such as sales taxes. Liberalization of trade is also an objective, and that includes liberalization of agricultural trade. From the point of view of the destination country (the North), a control of immigration is also an objective that could be for an economic reason (to impede a raise of unemployment in the North) or for a sociological one (to prevent a decrease in social capital). Finally we could identify a "social clause" as an attempt to limit the size of the informal sector in the South, insofar as the informal sector does not respect any labor regulation and can have a salary level below the minimum wage.

A) Small alpha case

When α is "small", liberalization of agricultural trade will foster international migration, will develop the national informal sector, and will increase the number of unemployed people. If we finance the decrease in customs duties by an agricultural tax, the effect of the raise in taxes will be to increase further emigration and national informal sector, and to decrease real rural wage and the number of people employed in urban formal sector. In summary, conditions are going to get worst, but the budgetary equilibrium will be maintained. Things are similar when budgetary equilibrium is obtained thanks to a raise in manufactured sales tax t_u, except when « a » is sufficiently big ($a>a_2\geq 0$). This case means that Q_i (size of national informal sector) is positively related and sufficiently sensitive to t_u, so that the expansion of national informal sector in response of a raise in t_u will be sufficient to absorb the rural-urban migration, and emigration toward foreign informal sector could decrease (but not necessarily, since the effect of a drop in d_a, *ceteris paribus*, is an *increase* in international migration).

In the case of a "small α country", liberalization of agricultural products is not consistent with other objectives like budgetary equilibrium, control of migrations and social clause. It is possible to maintain liberalization and budgetary equilibrium if we remove the objectives of control of migration and social clause. If we finance the reduction in custom duties by a raise in t_u and if the size of national informal sector is positively related and sufficiently sensitive to t_u it is possible to have an expansion of informal sector big enough to avoid an increase in international migration. So the lesson of the model is that in the case of a East-European country or a Latin American country, where α is likely to be small, it is difficult to pursue at the same time the objectives of a control of migration, liberalization, budgetary equilibrium, and reduction of national informal sector (as a kind of "social clause").

B) Big alpha case

When α is big, as in the case of Southern Mediterranean countries for example, the situation is better. As a matter of fact, when α is big, liberalization of agriculture is compatible with a decrease in international emigration and in the size of informal sector, and it does not necessarily imply an increase in the number of unemployed. Taking into account the effects of a rise in sales taxes the previsions may be less optimistic, since the increase in sales taxes will generally have a expansive effect on the informal sector and the international migration (except in the case of a high positive value of "a", i.e. $a>a_2\geq 0$, where international migration can decrease). So the combined effect of a reduction in custom duties and an increase in sales taxes is not clear. Nevertheless, even if the combined effect is not going in the sense of a better control of migration and a lesser size of informal sector, it is possible to drop the budgetary equilibrium objective, and still pursue the three others.

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Annex

Value of α in 66 Countries (other European countries, as well as North American countries, Japan, Australia or New Zealand, have value of α below 20%). Calculated by USDA-ERS, using 1996 data.

Country	Total Food Expenditure (% total expenditures)	Country	Total Food Expenditure (% total expenditures)
Nigeria	72,97	Bahamas	35,73
Albania	69,26	Jamaica	34,78
Madagascar	65,88	Macedonia	34,73
Vietnam	64,75	Russia	34,35
Sri Lanka	63,55	Estonia	33,45
Sierra Leone	62,09	Botswana	32,80
Yemen	61,13	Argentina	32,79
Bangladesh	56,05	Turkey	32,60
Benin	55,40	Iran	32,55
Malawi	53,35	Slovakia	32,06
Senegal	53,35	Korea	31,64
Mali	53,27	Belize	31,17
Indonesia	50,62	Bulgaria	30,70
Philippines	48,35	Poland	30,65
Egypt	**48,08**	Peru	30,31
Gabon	47,94	Venezuela	29,47
Syria	**47,92**	Ecuador	29,09
Pakistan	46,99	Thailand	28,56
Congo	46,92	Bahrain	28,55
Kenya	45,82	Mauritius	28,12
Morocco	**45,61**	Swaziland	27,48
Romania	45,26	Paraguay	27,27
Ukraine	45,03	Mexico	26,63
Cote d'Ivoire	44,32	Qatar	26,22
Cameroon	43,80	Zimbabwe	25,58
Guinea	43,69	Uruguay	25,25
Moldova	43,45	Czech Republic	25,00
Bolivia	42,52	Portugal	23,23
Lithuania	40,42	Chile	22,96
Lebanon	**39,33**	Brazil	22,71
Dominica	38,27	Hungary	22,54
Jordan	**37,67**	Slovenia	21,34
Tunisia	**35,95**	Greece	21,17

Source: US Department of Agriculture, Economic Research Service (http://www.ers.usda.gov/data/InternationalFoodDemand)

CHAPTER 2: Migration of Highly Skilled Labor and the New Economics of Brain Drain

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This chapter looks at the determinants and impacts of the migration of skilled labor from developing (South) to developed economies (North). In the absence of cross-section data about individual and group choices, only aggregate secondary and incomplete data can be used to understand and assess the overall determinants and impacts of the migration of skilled labor. The available publications related to the migration of skilled labor with its relationship to economic and social development show the diversity and richness of the material developed so far. The accumulated knowledge focuses on the perception and loss of qualification at the source of emigration with emphasis on the potential gains transferred to destinations. It also insists on the perceptions related to the educational and training costs invested at the origin and to the experience accumulated by the emigrant, mainly when public budgets and expenditures are involved. The overall direct and indirect benefits and costs that are related to the processes of emigration of skilled labor have also constituted important components in the economic literature. Finally, it can be derived from the accumulated knowledge that the higher intensity of emigration of skilled labor from the same given sources has shown a large body of reports and publications indicating the directions of losses and gains between developing and developed economies especially in the era of globalization and increased competitiveness and where knowledge is the most important driver (Driouchi & al., 2006). This chapter starts with a comprehensive literature review about the determinants and the impacts of the migration of skilled labor. This is followed by a description of the methods and data used to assess both the determinants and the impacts using some selected models. The results obtained are then submitted before tackling their discussion with the implied economic policy issues.

2.1: Review of Literature on Migration of Skilled Labor

Different approaches to migration have been identified and different assessments have been developed. These approaches are mainly based on the relationship between developing and developed countries with the possibilities of enhancing the likely benefits that can be obtained from this migration. In relation to that, some authors have considered the brain drain to be negative to developing economies while others have been more in favor of negotiated solutions as gains are observed to occur to source countries. This latter literature is now progressively shaping international and national policies.

2.11: Determinants of skilled workers' migration

The rate of skilled workers' migration (brain drain) continues to increase so it was necessary to know the causes of this migration. They are identified by the International Organization for Migration (IOM) as driving forces from both the side of developed and developing economies. Technological revolution played an important role in increasing the rate of migrants to countries where information and communication technologies are abundant, thus demanding highly skilled workers. Globalization has also an important role in encouraging developed economies attract the workforce of the developing ones. Moreover, the decrease in population added to the shortage of developed countries related to skilled workers accelerates migration towards some sectors such as health care. The large body of reports developed by the International Labor Office has been useful in understanding series of economic, social and policy issues related to human migration in general and to skilled labor in particular. Report 44 by Lindsay Lowell and Allan Findlay (2002) underlines the absence of databases that directly deal with high skilled labor migration. Report 73 by Gloria Moreno-Fontes Chammartin & Fernando Cantù-Bazaldùa (2005) has set some prospects for migration in the context of the enlargement of the European Union. The prospect for skilled labor migration is high as workers are supposed to settle where their productivity and wages are higher. The factors behind this high prospect include income gaps, the social and the network systems and the attractiveness of the educational system in Europe.
The existing literature recognizes that the "brain drain" is another aspect of international mobility that worries researchers and political leaders, from the North and the South, and emphasizes the idea of cooperation between labor transmitting and labor receiving countries. The effect of asymmetric information was introduced by Kwok and Leland and commented by Katz and Stark. Asymmetric information in labor market according to Kwok and Leland is the reason behind the brain drain in less developed countries. Since employers abroad are better informed about workers' productivity than domestically, they offer better wages making skilled employees prefer to stay abroad. However, under alternative scenarios of asymmetric information, less skilled workers migrate from less developed countries more than highly skilled labor. Depending on which side the information is present (rich or poorer country), asymmetric information tend to encourage migration. From the side of a poorer country (ex. Taiwan), the asymmetric information may support low-skilled workers' migration. From the rich country side (ex. USA), asymmetric information might cause the migration of highly skilled workers (Katz & Stark, 1984).
In their reply to this, Kwok and Leland found that the example of Katz and Stark is another result of their research: skilled workers will stay in their home country while less skilled workers might migrate, if reverse information asymmetries exist (if the poorer country can better screen its workers than the rich one). When sufficient wage

differential is available, emigration of the least talented workers can occur but will often be partial. Migration and government policies affecting mobility can then be discussed in relation to informational asymmetries and relative wages (Kwok & Leland, 1984).

2.12: Effects of Brain Drain on the welfare and growth of source countries

The issue of knowing whether skilled migration is detrimental to the welfare of the populations in the countries of emigration has engaged, for a long time, wide debates in the development literature. These debates include those that emphasize the negative effects of brain drain and those that consider the existence of positive gains to source countries.

The work concerning the international emigration of skilled labor force, considered as talent drain from the least developed economies towards the most developed, had rather unanimously advanced following the idea that *brain drain is unfavorable to the development of the source economy* (Bhagwati & Hamada, 1974). The principal arguments justifying this situation are related to different types of externalities, induced by the migration of human capital, which are imposed on the remaining population. Bhagwati and Hamada (1974, 1982) show that the emigration of the most skilled labor force generates a tax externality associated with a distortion of the optimal tax system on two levels. On the one hand, knowing that the most skilled agents are better remunerated, government loses in terms of tax income due to its agents' drain, which affects the potential size of revenue redistribution. In the same way, the investment in terms of education and training represents major costs for developing countries which cannot receive benefits in return since the migration of skilled labor takes place.
Bhagwati and Dellalfar (1973) proposed a tax on professional emigrants' income for an approximate period of their ten first years in the host country. This tax is supposed to be collected by UNDP and distributed in the countries of origin. However, there are administrative problems associated with tax collection, the problem of non-benevolent developing governments, and the extent to which a brain drain tax should be integrated in the tax system of the country of origin. To avoid these problems, a small tax on the incomes of citizens living abroad was considered as a possible approach in collecting a brain drain tax (Wilson, 2005).
Bhagwati and Partington (1976) and Bhagwati (1976) discuss the feasibility of the tax on residents' income in the host country. This tax cannot be gathered by all developed countries (different political systems and constitutions) but might be collected by developing countries through a multilateral treaty. Maynard (1976) criticized the depth of analysis of Bhagwati and co-authors regarding the definition of developed and developing countries, the definition of equity in terms of distributing resources, the compensation principle (10% tax for 10 years), the over production of professional and technical personnel by underdeveloped economies, and the efficiency of the international redistributive mechanism (free riders, efficient use of funds).

Blandy (1968) constructed a model through which he assessed the brain drain phenomenon. He found out that migration is multidirectional (not only into North America) and is a complex movement attached to political, economic and educational development processes. Two conditions should hold to conclude that brain drain exists.

The first condition is when the migration of highly skilled workers is growing more rapidly than the number of highly skilled labor in the home country. The second is when the difference between these rates of increase is greater than the difference between the rates of increase of migration as a whole and the economically active population as a whole.
According to the endogenous growth theory, the migration of competencies imposes an externality whose origin lies in the reduction of local human capital stock available for present and future generations. This implies a negative effect on the income of workers who didn't emigrate or on the growth rate of the source country. Moreover, qualified work is an instrumental factor in attracting foreign investments (Fujita et al. 1999) as well as in the capacity of assimilation and absorption of technological externalities or for the success of foreign technologies adoption (Benhabib and Spiegel, 1994).
Furthermore, within the framework of the new theory of endogenous growth, the human capital drain is unfavorable to development (Miyagiwa, 1991; Haque and Kim, 1995) since the loss in human capital resulting from skilled workers emigration decreases productivity and income per-capita. Miyagiwa (1991) for example, shows that in the presence of increasing outputs from education, the emigration of very skilled workers can decrease the income of workers with intermediate skills either these latter migrate or not. Under certain conditions, this author shows that the national income of the source country can be lower than the one that would prevail in the absence of migration. Thus, the brain drain was identified as a serious problem against which policies had to and could act. Haque and Kim (1995) think that education policy is the answer. Since educated people are more likely to emigrate, in an open economy, then education should focus in primary and secondary levels. Even though remittances counterbalance the effects of brain drain, Haque and Kim (1995) found that these remittances have a negative effect on the growth of the home country.
Using the simple economic model of labor demand and supply, Mishra (2006) assessed the quantity of welfare loss that results from labor movement both when external effects do not exist and when they do. When external effects of labor migration are not taken into consideration, the emigration loss is the surplus resulting from the difference between the cost of employing the workers who migrate and the value of their marginal product. This welfare loss is due to the cost imposed on those who were left behind. Accounting for external effects, Mishra (2006) found that the loss from skilled labor migration is greater than without external effects.

Very recently, the models and analyzes related to the negative impact of human capital migration, gave slowly the place to models and studies aiming at the identification of potential transmission channels through which the migration option as well as the possible money transfers could constitute a considerable source of income for the development process of the source country.
The new literature tries to show that potential net positive effects on human capital accumulation and growth can be associated to human capital migration. Consequently, the unfavourable effect of the exodus of competencies can be reversed. Therefore, the expression "Brain Drain" becomes "Brain Gain". In this new literature, it is suggested that the brain gain could be associated with the inciting impact created by the migration prospect on the size of human capital formation in an environment of uncertainty. According to Mountford (1997), the migration possibility even if temporary might enhance the average level of productivity of the source economy in a permanent way.

The general idea is that, in poor economies, the net yield of human capital tends to be limited, thus inhibiting the incentives to invest in education and training. However, open economies offering migration possibilities make the human capital acquisition more attractive since wages of skilled workers are higher in developed countries. This can lead to an increase of the medium level of human capital in the remaining population according to Beine et al. (2002). In this new literature, in a context of uncertainty and heterogeneous individual aptitudes, two brain drain effects are highlighted: a natural incentive effect to the human capital formation, and a rather drain effect which appears with the effective departure of the economy's talents. So, the human capital migration can be globally beneficial to the country of origin, when the first inciting effect dominates the drain effect by compensating for the negative direct impact of the brain drain on the human capital stock of the considered country.

A survey of the empirical and theoretical literature, done by Docquier and Rapoport (2005), on skilled migration effects on developing countries stated that the level of development for a country is inversely related to its optimal rate of migration. Furthermore, education policy strengthens the possibility of a beneficial brain drain, given that education is partly publicly financed through education subsidies. The fiscal adjustments to the brain drain can lead to tradeoffs between efficiency and social justice. That is why Bhagwati's tax can represent more benefits for the sending countries when investments in education are liquidity constrained (Docquier & Rapoport, 2005).

Grubel and Scott (1966) already said that if the human capital migration is a social cost in the short run, it is possible that this cost can, under certain conditions, be largely compensated in the long run through the transfers' potential, and the beneficial impacts emanating from the professional networks set abroad. There are two ways of carrying out the 'brain gain': either through the return of migrants to their country of origin (return option), or through their mobilization by associating them remotely to the development of their country of origin (network of experts' option). The return option was successfully carried out in various newly industrialized countries such as Singapore, Taiwan, Hong Kong and Korea. The theoretical results of the new literature thus corroborate the argument of Grubel and Scott (1966), and suggest that the impact of emigration on the source countries could be rather positive. Consequently, in terms of economic policies, these works quite naturally encourage developing countries to open their borders, and to authorize migration in order to maximize its positive effects.

Oded Stark also brought another perception of the brain drain. Since the familial and capitalist production functions are imperfect substitutes, migrant children might provide a positive role in the economy. An agricultural family that decides to move from "familial production" to "capitalist production" faces two constraints: "investment capital" constraint and risk constraint. The family tries to find solutions to the market imperfections it faces by driving the most suitable family member to rural-urban migration. This migration diminishes risks, given that the urban work is independent of agricultural production. Children are seen to yield different utilities: consumption, income, and status, security & insurance. However the role of the migrants is to cause technological change by increasing income. Education allows such scenario, given that farmers use the educational system to prepare their children for migration. The total utility from children is increased when specialization by children in the different utilities production exist. A social-welfare implication arises given that private optimal behavior (family) doesn't differ from the social optimal behavior (Stark, 1981).

In his review of “The Migration of Labor”, Todaro (1991) emphasized Stark’s belief that migration is initiated by family decisions. Stark believes that migrants are driven by the wage differential, expected income and other factors and that migration is the result of incomplete and imperfect markets. Korner (1992), who has done the same review, presented Stark’s findings according to which, the individual-family cooperation and the markets’ mode of functioning are the causes of migration. This latter occurs when a group of people, determined to rationally allocate common resources, make economic decisions. So, migration is seen as a way to alleviate risks and is due to national and international market imperfections as well as institutional distortions. Stark also connects migration to information regimes, risks, remittances and economic performance of the migrants (Korner, 1992). In addition, Molho also identified from Stark’s “Migration of Labor” that many factors, such as highly imperfect markets in rural areas, credit access constraints, and risks and hazards, drive small farming families to send their most eligible member to urban areas or, in a more general sense, to migrate. The remittances sent by the migrant can alleviate risks related to new investments (in technology for farm production). Stark studied the role of relative depravation as well as that of information asymmetries when employers are faced with workers whose skills’ level is undetermined. Concerning the theme “Planning with migration”, Stark found out that government efforts to decrease labor movements were unsuccessful and that this phenomenon might be beneficial in a social framework. The economic performance of migrants depends on migrants’ characteristics, on informational asymmetries driving the migrant to take self-employment risks and to save in case of return migration (Molho, 1992).

Stark also identified the effect of one migrant altruistic relation with his family members or social group on his allocations and wellbeing and estimated the impact of the timing of intergenerational transfers of allocations on the recipients’ human capital formation. Stark found that the altruistic behavior of the migrant and his family can be driven from self-interest since the actual transfers of the migrant to his family might influence future transfers from his own children (Todaro, 1997).

In another paper, Galor and Stark found that the probability of return migration affects migrant’s savings and economic performance. Compared with the native-born, migrants’ savings can decrease even with a small return probability (a decrease of the migrant’s wage). The model adopted by these two authors defines saving patterns between the migrants and the native-born. Therefore, the higher the probability of return migration, the higher is the level of savings. As a consequence of the possibility of return migration, migrants save more than the native-born. If return migration does not take place, migrants’ wealth outweighs the wealth of the native-born (Galor & Stark, 1990). This relationship between the possibility of return migration and the migrants’ saving behavior can explain the migrants/native-born performance: if return migration doesn’t occur, the migrants’ performance will be superior to the native-born one. Also, migrants with a positive probability of return will have higher mean incomes than the native-born, but if they decide to transfer some of their savings as remittances, the migrants/native-born differential will decrease. Migrants contribute more to capital formation in the source country compared with the native-born. That is why country policies should keep the return probability higher than 0 (Galor & Stark, 1990).

Starting from a sample of 50 countries, Beine et al. (2002), who brought an innovation to the brain drain literature with their empirical results, show that the rate of emigration of the most skilled, positively and significantly influences human capital accumulation and growth. Most countries that are positively affected by the brain drain combine both low levels of human capital and low emigration rates for the highly educated. Negative growth countries appear in countries where 20% and up of the highly educated migrate and/or where up to 5% of the total population are highly educated. Both winner and looser countries exist, but the proportion of winners includes the largest countries in terms of demographic size (80% of the total population of the sample). Empirical studies showed that at an aggregate level, brain drain is not anymore seen as extractor of the most valuable human resources from poor countries, but needs a better understanding of the conditions and causes of negative brain drain. An extension for this research could include, in addition to education, remittances and business networks' creation.

However, Faini does not validate this result in his study. He didn't find convincing proof about the bias that skilled migration in destination countries can benefit home economies, especially because of the globalization process that is harmful to poor countries. He also stated that a more liberal skilled migration policy can have an unfavorable effect on tertiary enrollment which contradicts the possible increase in the return to secondary education. Thus, return migration does not necessarily have an evident beneficial impact. Therefore, policy makers are expected to strengthen multilateral trade systems and limit the repetition of financial crises in emerging economies (Faini, 2003).

Schiff (2005) minimizes the size of the brain gain and its effect on growth and welfare compared with the new brain drain literature. The size is smaller because of heterogeneity, unskilled migration, uncertainty, brain waste and general equilibrium effects. The brain gain is smaller (or negative) with limited impact on welfare and growth. He shows that brain drain exceeds brain gain in constant state and agrees with contributors to the early brain drain literature, who viewed brain drain as a trigger of loss for the home country. The author agrees with the new brain drain literature on one point related to the most severe brain drain cases where the net brain gain is negative (Schiff, 2005).

According to Stark (2002), the decision to under-invest in costly human capital formation may be reached if an individual productivity is fostered by the average level of human capital in addition to his own human capital (in a closed economy), and thus affects social welfare. Migration can allow the formation of human capital at a socially desirable level. Besides, acquiring skills enhances the chances of having high skills rewarded. Grubel and Scott didn't refer to the relationship between migration and welfare gain for the non-migrants even though they mentioned that emigration should be encouraged given that the emigrant improves his own income and that those who remain behind are not affected by the migrant's departure (Stark, 2002). He also demonstrates both results of the prospect of migration: brain drain and brain gain and he found that a good migration policy can lead to welfare gain for all workers.

The debate that turned over the advantages and costs of skilled migration resulted in many analyzes. It should be recognized that this kind of migration is costly in terms of the country of origin's finances and economy.

2.2: Methods of Investigation

These methods are mainly those that helped assess respectively the determinants and the impacts of skilled labor migration. Besides the theoretical grounds on which each investigation has been conducted, the empirical models used are respectively based on regression analysis and simulations. The data are mainly aggregates from a diversity of sources.

2.21: Factors that could explain Emigration of skilled labor

The available reports and publications show that there are many factors that could explain the emigration of skilled labor to other destinations. The number of these factors is recognized to have increased with globalization and with the development of competitiveness through knowledge and ownership of skills. The liberalization and openness of economies relative to the period of government intervention are also among the factors that contributed most to the enlargement of the set of likely explanatory variables that are behind emigration. In this context, subsets of current variables are provided in reports and publications.

Relatively to the levels of variables in the source countries, the likely factors include the expected monetary gains, the living conditions, the working conditions, and the state of human rights, the accessibility to the emigration costs, and the accessibility to information, quicker promotion and acquisition of social status with easier access to networks and to professional support. Furthermore, the absence of jobs and decent occupations in the source country leads automatically skilled labor workers to search for opportunities elsewhere.

2.22: Models used to assess impacts

The models adopted in the measurement of skilled labor migration impact on source and destination countries, in terms of human capital formation and growth, are divided into theoretical and empirical studies.

The model presented by Beine, Docquier and Rapoport (2002) is an empirical assessment of the growth effects on home countries of skilled labor migration. Beine et al. used Carrington and Detragiache data (1998) concerning the emigration rates at three educational levels for a set of 50 developing countries. The results of this empirical study showed that brain drain can be beneficial as well as disadvantageous for the source countries. In addition, given that it is possible for brain drain to generate benefits for the source country, it is necessary to expand studies to means other than education.

From Beine's et al. model, the higher the personal ability of an individual, the lower is the cost of achieving the minimal education threshold, which also depends on other country-specific variables affecting human capital. In this model, the education investments in a given country can explain a higher initial level of human capital inherited by the following generation. The human capital growth rate equation shows two effects: the brain effect and the drain effect. Two equations are then used to estimate the global effect of the brain drain and to evaluate the expected growth effect of a marginal increase in the migration probability (Beine et al., 2003)**.**

Stark's et al. consider that migration is assumed to have no cost of movement. In that case, the function of the expected net earnings of the workers in the sending country equals gross earnings given the probability of migration minus the costs of capital formation. For any m between 0 and 1, the level of human capital in an open economy setting exceeds that of a closed economy setting, but it is below the level of human capital in the destination country (Stark et al., 2005).

Nguyen Duc Thanh (2004) presents a theoretical model including the heterogeneity of workers' talents. The accumulation of human capital stock depends on the human capital investment expenditure and talent (The human capital formation function). The higher the probability of emigration π, the less is the human capital accumulation: 'Emigration Trap' meaning that emigration constraints always result in a net brain drain effect. The optimal emigration probability is achieved when the economy maximizes its domestic human capital stock at a given probability after which the country starts to lose its human capital (N. Duc Thanh, 2004).

Maurice Schiff (2005) presents other results focusing on the size of the brain gain that is smaller than the results presented in the other new brain drain literature, and thus the effect on growth and welfare are lower.

2.23 : Description of data used

Different databases are used to assess the impact of skilled labor migration on the sending country as well on destinations. The indices of skilled labor migration are taken from the most recent OECD database. There are five indices used: The highly skilled expatriation rate according to Cohen and Soto database for the population of 15 and plus (EM1), the highly skilled expatriation rate according to Barro and Lee database for the population of 15 and plus (EM2), the average of EM1 and EM2 (EM3), the emigration rate by country of birth - total population (EM4), and the emigration rates by country of birth for the population of 15 and plus (EM5).

Knowledge and socio-economic data are obtained from other databases and sources. The corruption perception index (CPI) is published by Transparency International. It is a composite index based on the corruption data in experts' surveys. The Index of Economic Freedom (IEF) is available at the Heritage Foundation. It measures how much a country is economically free by assessing its trade policy, government fiscal burden, intervention of government in the economy, monetary policy, capital flows and foreign investments, banking and finance, wages and prices, property rights, regulation and informal market activity (Heritage Foundation, 2006). The Knowledge Economy index (KEI) is obtained from the World Bank Institute. The KEI measures the degree of acquisition, creation, use and access to knowledge. It sums up indicators related to a country's economic incentive regimes, its innovation ability, its education system, and its information infrastructures. The Gross Domestic Product Index (GDPI) is a measure of the per capita level of income resources accessed by all the individuals in a given country. It was computed by IEAPS by normalizing the per capita GDP data and serves

as a reasonable indicator of a country's wealth. The GDP is published in the Human Development Report 2005 by UNDP. The Human Development Index (HDI), also published by UNDP, measures the average achievements in a country in terms of a long and healthy life, knowledge and a decent standard of living.
Labor market variables including employment information are taken from the World Bank database, the index of tertiary education as a subcomponent of the education index included in the knowledge economic index is published by the World Bank Institute (2006). The investment per capita in higher education is measured by the expenditure per student devoted to tertiary education as percentage of GDP per capita (World Bank database, 2005). The relative wage in different immigration economies (ω) is measured by relative GDP per capita (World Bank database, 2005). International Monetary Fund (IMF) database was also used.

2.24: Empirical results

A) Assessment of Determinants of Skilled Labor Migration

All countries in the sample show results that link positively KEI and HDI, IEF and GDPI but the second regression indicates negative correlation between IEF and CPI. These results are consistent with the definition and the scales of each of the indices used in these regressions. Regarding the emigration rates as measured respectively by EM1, EM2 and EM3, they appear in each regression to be negatively related to both IEF and KEI meaning that the increase (decrease) in IEF leads to less (more) emigration or that the openness of the economy implies more incentives to emigrate. At the same time, increases (decreases) in KEI imply less (more) emigration. But the emigration rate is under the double effects of KEI and IEF. Given the three other relationships, the emigration rate is statistically assumed to decrease (increase) with the increase (decrease) of the human development index and with the increase of the corruption perception index. These results may be interpreted as saying that emigration increases with low human development and with corruption.

Table 1: Emigration explained by economic, social and political variables (All countries in the sample)

All countries in the sample	Obs.	R^2
$KEI = \underset{(-9.74)}{-4.13} + \underset{(20.63)}{12.05}\,HDI$	110	0.80
$IEF = \underset{(51.08)}{3.96} - \underset{(-15.06)}{0.24}\,CPI$	110	0.68
$HDI = \underset{(26.56)}{0.34} + \underset{(31.58)}{0.74}\,GDPI$	110	0.90
$EM1 = \underset{(5.15)}{0.79} - \underset{(-5.07)}{0.05}\,KEI - \underset{(-3.41)}{0.14}\,IEF$	92	0.226
$EM2 = \underset{(6.03)}{0.57} - \underset{(-3.55)}{0.04}\,KEI - \underset{(-2.22)}{0.09}\,IEF$	97	0.128
$EM3 = \underset{(4.09)}{0.53} - \underset{(-3.90)}{0.03}\,KEI - \underset{(-2.57)}{0.09}\,IEF$	110	0.127

These results are better confirmed with the sample of developed economies for each of the dependent variables measuring emigration with weaker relationship between emigration rates and KEI.

Table 2: Emigration explained by economic, social and political variables (Developed Countries)

Developed countries	Obs.	R²
$KEI = \underset{(-3.23)}{-15.91} + \underset{(4.93)}{25.89} HDI$	25	0.51
$IEF = \underset{(10.85)}{3.32} - \underset{(-4.20)}{0.16} CPI$	25	0.43
$HDI = \underset{(16.60)}{0.68} + \underset{(6.26)}{0.31} GDPI$	25	0.63
$EM\,1 = \underset{(3.13)}{0.86} - \underset{(-2.46)}{0.06} KEI - \underset{(-3.00)}{0.13} IEF$	22	0.334
$EM\,2 = \underset{(4.03)}{0.82} - \underset{(-2.69)}{0.05} KEI - \underset{(-4.45)}{0.14} IEF$	24	0.492
$EM\,3 = \underset{(2.98)}{0.57} - \underset{(-1.94)}{0.04} KEI - \underset{(-3.19)}{0.10} IEF$	25	0.321

Similar directions are observed among developing countries but with stronger relationships between the emigration rates, IEF and KEI.

Table 3: Emigration explained by economic, social and political variables (Developing Countries)

Developing countries	Obs.	R²
$KEI = \underset{(-5.49)}{-2.15} + \underset{(13.87)}{8.34} HDI$	85	0.70
$IEF = \underset{(30.78)}{4.05} - \underset{(-6.97)}{0.27} CPI$	85	0.37
$HDI = \underset{(19.72)}{0.32} + \underset{(20.99)}{0.80} GDPI$	85	0.84
$EM\,1 = \underset{(4.40)}{0.80} - \underset{(-3.03)}{0.05} KEI - \underset{(-2.92)}{0.14} IEF$	70	0.16
$EM\,2 = \underset{(2.74)}{0.54} - \underset{(-2.38)}{0.04} KEI - \underset{(-1.57)}{0.08} IEF$	73	0.076
$EM\,3 = \underset{(3.41)}{0.53} - \underset{(-2.49)}{0.03} KEI - \underset{(-2.11)}{0.09} IEF$	85	0.081

MENA Countries observe the same directions, also with weaker relationships between emigration rates and KEI.

Table 4: Emigration explained by economic, social and political variables (MENA Countries)

MENA countries	Obs.	R²
$KEI = \underset{(-3.31)}{-6.39} + \underset{(5.47)}{14.22} HDI$	12	0.75
$IEF = \underset{(8.17)}{4.12} - \underset{(-2.27)}{0.27} CPI$	12	0.34

$HDI = \underset{(9.09)}{0.40} + \underset{(7.93)}{0.64}GDPI$	12	0.86
$EM\,1 = \underset{(2.68)}{0.75}GDPI - \underset{(-2.08)}{0.04}KEI$	9	0.56
$EM\,2 = \underset{(3.02)}{0.28}GDPI - \underset{(-1.77)}{0.02}KEI$	11	0.79
$EM\,3 = \underset{(3.22)}{0.13} - \underset{(-1.52)}{0.014}KEI$	12	0.19

The overall results obtained show how economic (GDPI, IEF), social (HDI) and political variables (CPI) can explain the directions and magnitude of emigration from a given country. They clearly indicate that bad economic, social and political conditions explain the emigration as measured by the special two measures of skilled labor and their average.

Others results are based on the comparisons of the determinants of both the total emigration rate and that of skilled labor. These results confirm again the roles of the economic, social and political determinants as they have been shown in the first set of regressions. Throughout these estimations of new determinants of skilled labor migration, it can be said that the new indices for knowledge, corruption perception and openness of the economy have been useful in capturing important information that appears to be useful explaining the emigration rates and mainly those related to skilled labor. Besides, these results, the previous studies have shown that the incentives provided by destination countries with even special fiscal policies, are also important drivers of emigration. Furthermore, the factors related to distance, proximity, language and the existence of colonial or historical ties with destination countries are also important factors that can explain the pull of skills from developing economies.

B) Impact assessment of skilled Labor Migration

The literature on skilled migration and the implications on human capital formation and growth rate are almost exclusively theoretical. The studies of Beine et al. (2001 and 2003) are empirical evaluations of the growth effects of the brain drain for the source countries of migrants. This paper uses the results of Beine et al. and applies this model to a set of 64 developing countries taking only the variables affecting human capital formation and growth rate.

Hence, using the growth effect of a marginal increase in the migration probability and the Beine et al. model, the estimation results are given in the following table (where hum_i is the ex-post proportion of educated agents within the previous generation (once migration has been netted out) from the Beine et al. model and ASEExp_{2000} are the adjusted savings for the year 2000 as percent of GNI taken from World Bank database).

Table 5: Econometric estimations of Beine & al Model

Developing countries		R²	n
Estimated equation: human capital $m'=(1+m)/(0.65+m^2)$	$\Delta H_{1990/2000} + d_H H_{1990} = \underset{(5.049)}{0.269} m'_{1990} - \underset{(-3.259)}{0.469} HDI_{1995} + \underset{(1.640)}{0.021} ASEExp_{2000}$	0.696	62
Estimated equation: GDP growth	$GDPgrowth_{2000} = \underset{(4.679)}{5.011} hum_{2000} - \underset{(-4.029)}{1.692} hum^3_{2000}$	0.680	64

Based on the conditions imposed by the theoretical model, the different values defined above are calculated and applied to the situation of each country. The corresponding results that allow the knowledge of the overall impact of emigration are introduced below for a sub-sample of countries. Again, most of Beine's & al results are confirmed and brain gains take place for all developing countries but only few countries do not benefit from increased emigration. The models of Stark & al and of N. Duc Thanh will provide further detailed results.

C) Tests using Stark's and al, Model

The main task here is to test the relevance of Stark's & al model through mainly the basic decision rule (equation 6 in the paper) that is $\tilde{\vartheta}^{S*} = \frac{m(\beta^D - \beta^S) + \beta^S}{k} - 1$. The variables β^D and β^S are labor productivities considering the USA as a reference country (International Labor Organization, 2006) and k is relative education expenditures (Public spending on education as % of GDP) over the educational expenditures of the USA (World Bank Data, 2006). The variable $\tilde{\vartheta}^{S*}$ is the level of human capital calculated using Stark's et al. model; KEI and KEIEducation are respectively the knowledge economic index and the index of education as a component of the knowledge economic index.

Table 6: Tests using Stark's and al, Model

Equations (developing countries)	R²	n
$KEI_{2003/04} = \underset{(4.862)}{0.417} \tilde{\vartheta}_1^{S*}$	0.507	24
$KEI_{2003/04} = \underset{(4.652)}{0.353} \tilde{\vartheta}_2^{S*}$	0.485	24
$KEIEducation_{2003/04} = \underset{(4.983)}{0.436} \tilde{\vartheta}_1^{S*}$	0.519	24
$KEIEducation_{2003/04} = \underset{(4.676)}{0.366} \tilde{\vartheta}_2^{S*}$	0.487	24
$KEI_{2003/04} = \underset{(15.827)}{21.159} \beta^S$	0.916	24
$KEI_{2003/04} = \underset{(10.628)}{4.743} \beta^D$	0.831	24

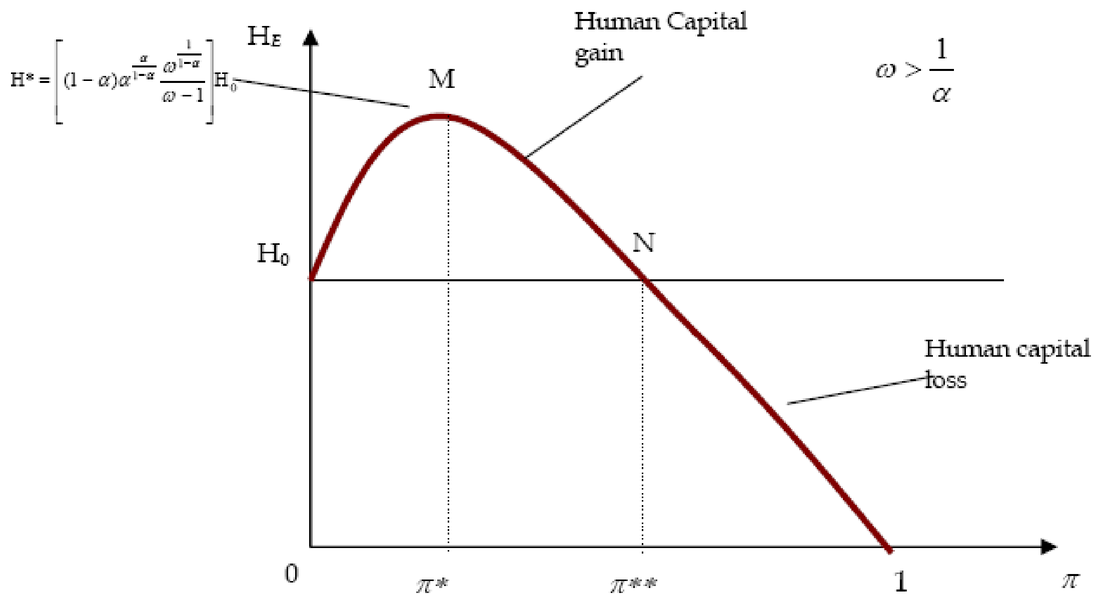
These results show that the labor productivity in developed and developing economies are related to the exogenous index of human capital as it is represented by KEI. This latter is also positively correlated with the calculated level of human capital using Stark's decision rule (equation 6 in Stark's & al, 2005).

Some figures represent the optimal level of human capital ($\tilde{\vartheta}^{S*}$) given different probabilities of migration (m), when the countries of destination are, first, the northern countries and second, the Middle Eastern.

D) N. Duc Thanh model (Heterogeneous Talents and Optimal Emigration, 2004)

The following figure reproduced from the paper by the author (page 9) shows how the consideration of heterogeneous skills lead to an overall human capital formation that varies with the levels of migration probabilities. The major conditions underlying this model are that relative wages in the destination and source countries are higher than one and that this wage ratio is higher than the inverse of the technical coefficient of the cost of education function (1/α)<ω). It shows also that when emigration is absent, the level Ho can be achieved. There are gains (brain gains) realized after reaching the level of migration π* that maximizes the level of human capital. Above this latter probability value, losses start to occur in the source country. An equivalent level equal to Ho is attained (N) when emigration attains the value π**. The level of capital is then definitely decreasing (brain drain) between π** and 1.

Figure1: Representation of the trends in human capital gain given different values of the probability of emigration



Source: Duc Thanh, Nguyen. Heterogeneous Talent and Optimal Emigration- A contribution to the new economics of the brain drain, Sept. 2004, p: 9.

In order to visualize the meaningfulness of this model, different simulations using different values for α, ω and π are first considered. Based on the empirical data available mainly for ω and the migration rate, H/H_0 is calculated for each developing country that is in the sample. The last step is to test for the existence of a relationship that could validate the N. Duc Thanh model. This is realized in two stages that are based on the introduction of the index of tertiary education enrollment as included in the knowledge economic index, Keied, (World Bank Institute, 2006), the investment per capita in higher education measured by the expenditure per student, tertiary as % of GDP per capita, c, (World Bank Database) and the ratio of country GDP, ω, which is equal to the ratio of GDP of the country of destination on the GDP of the source country (World Bank Database, 2005). This ratio is larger than 1 as required in the model. Stage 1 gives the results of the regression analysis of the logarithm of Keied as a function of the logarithm of c, while stage 2 represents the regressions of H/H_0 on the logarithm of Keied. The results of both stages are presented in the following tables.

Table 7: Result of the regression analysis of Keied on c for the developing economies when the average destination is Considered

Developing countries (Average Destination)	***n***	***R²***
$\ln(Keied_{2003/04}) = \underset{(8.94)}{3.60} - \underset{(-6.19)}{0.61}\ln(c)$	25	0.625
$\ln(Keied_{2003/04}) = \underset{(11.78)}{3.51} - \underset{(-3.76)}{0.35}\ln(c) - \underset{(-4.49)}{0.34}\ln(\omega)$	25	0.804

The above results show how the subcomponent of KEI as a measure of human capital is explained by expenditures on education which are measured as a share of GDP that is less than one (First equation) and is also explained by the relative wage variable that is higher than one (Second equation). It is worth observing that the coefficient of education expenditures is positive (negative here because c is less than 1), while the one on ln (ω) is negative. This leads to considering that human capital formation in relation to skilled labor (tertiary education) is related to the cost of human capital formation and to the relative wages of destination countries relative to the source of emigration.

Table 8: Test using N. Duc Thanh model (selection of the best regressions)

Equations (Average Destination)	**α**	**R²**	**n**
$\frac{H}{H_0} = \underset{(16.32)}{3.36} - \underset{(-8.08)}{0.42}Keied_{2003/04}$	0.34	0.547	56
$\frac{H}{H_0} = \underset{(13.07)}{5.42} - \underset{(-7.66)}{0.80}Keied_{2003/04}$	0.4	0.521	56
$\frac{H}{H_0} = \underset{(9.17)}{16.12} - \underset{(-6.46)}{2.87}Keied_{2003/04}$	0.5	0.436	56
$\frac{H}{H_0} = \underset{(6.42)}{114.42} - \underset{(-4.98)}{22.51}Keied_{2003/04}$	0.61	0.315	56

Based on the above regressions, it appears that the technical coefficient is around 0.34 and 0.61. With this remark two scenarios can be established for the set of sending countries included in the sample with the average destination.
These preliminary empirical results lead to considering the theoretical models suggested by Beine & al, Stark & al (2005) and Nguyen (2004). The latter models are based on the abilities and skills as the building block to the overall economic frameworks suggested. The second model has suggested a special specification that is based on the expenditures on education and heterogeneous talents.

E) Sources of Overestimation as in M. Schiff (2005)

The sources of overestimation of brain gains exist as they originates from brain waste, negative brain gain, risk aversion behavior and general equilibrium effects. The brain waste occurs when the skilled emigrant occupies positions that require lower levels of skills implying that the person is undervalued both on wage and knowledge accumulation. The negative brain drain takes place when receiving countries prefer to employ lower skills or unskilled emigrants implying that the positive expected effects on education in the source countries become limited or negative. In case, the above models are considered to account for aversion to risks, the human capital accumulation of knowledge and the brain gains are reduced by at least by a fraction of the variance of gains in case of constant absolute aversion. Expenditures on education is the other component that can lower the overall gains because of the difficulties under the limited and same level of resources to increase the budget for education without affecting the other sectors.

2.3: Discussion of Results & Policy Implications

The major results attained in this report relate to the determinants and impacts of skilled labor migration. The determinants appear to be those that have been largely described in the previous sources and documents. They all relate to the large differential in income, in living conditions, in access and use of knowledge, in freedom and transparency besides the availability of decent jobs and occupations. The implications are those that relate to a loss of flows of human skills but with lesser negative impacts on developing economies. These economies can still have access to remittances, foreign direct investments and other means that enhance the possibilities offered. Investment in education appears to exhibit promising positive effects if accompanied with larger access to local, national and international sources of knowledge. These processes are likely to generate new development opportunities that can be accelerated by the attraction of foreign investments, relocation of firms, promotion of new enterprises and then the expansion of the engine of growth. All these factors favor the attractiveness of the economy and accelerate the partial or permanent return of skilled labor. But, they are medium and long term issues that should be raised in relation to the intensification of emigration from

South to North. The factors of intensification can be related to the larger negative impacts of climatic changes with their direct effects on economies that are mainly based on agriculture and natural resources with limited focus on industries and services. The impacts of such dependencies on natural resources can enlarge income differences and living conditions between developed and developing countries if the current trends were maintained. These enlarged differences can be major sources for the intensification of emigration to developed countries, starting with skilled labor. Bu, as it can be seen from the results above, there are short run types of niches that can create new conditions in the developing world. Developing economies still have possibilities of engaging in a new dynamics that can increase the benefits from migration if new measures are attempted and reforms accelerated in different areas that include mainly educational reforms, promotion of knowledge and the lack of generalization of access to both knowledge and education.

2.31: Acceleration of reforms in education

Almost all developing countries are pursuing reforms of their education system. These reforms are targeting higher education and also the secondary and primary levels in order to ensure an overall change that aims at enhancing the overall performance of the education system. But, these reforms require higher public expenditures that can either increase the overall levels of public budgets or decrease the shares of expenditures that can be devoted to other sectors. Furthermore, these reforms should ensure a higher level of performance of the skilled labor to be expected. This higher level of performance should be measured in relation to the international levels attained elsewhere. It should also ensure besides the quality, the quantity of skilled workers including those that may migrate. The increasing involvement of the private sector in education with the development of accreditation and incentives to ensure more choices helps lower the budgetary burden on government operational and investment budgets. Since the public sector is not the sole employer and when the private sector cannot ensure employment for most of the graduates, this implies that current and future generations with and without experience may choose to migrate. Otherwise, a dynamic private sector will generate more opportunities to attract large shares of the graduates. But, the high quality of education may be viewed as a source of competitiveness that will help increase foreign direct investments and thus, the overall performance of the economy. This is what is happening in India, China and Taiwan. At the same time, developed countries will keep targeting skilled labor from the developing world through direct and indirect incentives (EU, Canada, USA and Australia).
This means that the reform of the educational system can be an important source of skilled labor for both developed and developing economies and that there is an optimal level under which graduates and experienced workers will choose to stay and an optimal level above which they will emigrate. This threshold may be lowered with the development of the private sector in developing economies.
While some developing economies have attempted reforming their overall education, others have placed more emphasis on the education of engineers and scientists. This can be seen as a short cut towards creating better conditions for attracting foreign companies and foreign direct investments. But, it is not clear that this short cut leads to sustainable

performances. Further comparisons and empirical investigations are needed to understand the appropriateness of this approach.

2.32: Promotion of Knowledge

While this sector is directly related to higher education, its outcomes are also important in promoting knowledge that is directly used and applied by the economy. Foreign direct investments, off-shoring and relocation require continuous efforts for monitoring costs of both raw material and substitutes besides labor productivity. The creation of local enterprises can use imported processes (franchises, others) but can also provide new local processes that can also be exported. Thus the research sector at both public and private levels can play an important role including the attraction and retention of skilled labor.

The importance of the driving role of knowledge has been confirmed in a recent empirical study (Driouchi & al, 2006) using the Cobb-Douglas model specification, where average GDP indices for 56 countries for the periods 1996 – 1998 and 1999-2001 were regressed on the Knowledge Economic Index (KEI) as independent variable. The regressions start with 1995 KEI in order to test both immediate and delayed effects of the knowledge diffusion. All the countries in the study show a positive statistically significant result at 5% confidence interval between the KEI and the GDP index. This finding encourages developing countries to concentrate their efforts toward the expansion of their knowledge base in order to enhance economic performance and to improve their competitiveness.

Regarding the impact of each of the four individual components of the KEI (the economic incentive regime, innovation, education, and information infrastructure) on GDP other regressions were established. As shown below there is evidence of a strong positive correlation between information infrastructure in the Asian, G7 and European countries, but less so for economic incentives and education. Starting in 1999, the innovation variable became significant for Asian and other developing countries. This result suggests that the more developed countries have already captured the initial gains from the creation of a high quality educational system and research network. Likewise through participation in the World Trade Organization (WTO) and to a lesser extent the European Union, there has been a reduction in trade barriers, reduced tariffs, increased competition, and expanded intellectual property rights protection. Consequently investments in information infrastructure stimulate economic performance through efficient financial systems and flexible labor markets that increase productivity and reduce cost. For the foreseeable future the developed countries will continue benefit by continuing to enhance their information infrastructure with Information and Communication Technologies (ICT) which, at the same time, strengthens their national innovation systems.

As confirmed in the above study, there is strong evidence of a positive correlation between the aggregate Knowledge Economy Index and the GDP per capita. This implies that the output or the performance of an economy is positively impacted by the existing knowledge base and by both public and private policies undertaken to expand this base. The significance of the policy related issues has prompted other researchers to consider the relationship between knowledge and national economic performance. In a recent study by the World Bank Institute (WBI), Dahlman found that increasing the knowledge base measured by the change in aggregate KEI can have an exponential increase a country's GDP (Dahlman, 2002).

Empirical studies of the United States economy emphasize the combined effect of physical, human, and knowledge capital to explain the differences in regional and national economic growth. For example, a recent study by (Moomaw et. al, 1999) found that when physical and human capital is taken separately to measure the influence on growth, the results are positive, but not statistically significant. However, when all the forms of capital (physical, human, and knowledge) are included, the results are positive and significant. Specifically the output elasticity of this broader concept of capital when considered within a Cobb-Douglas framework is 0.485. This means that a change of 1% in capital results in an increase of 0.485% in the level of economic output (Moomaw et. al, 1999).

2.33: Generalized Access to Choices in Education, Knowledge and Migration

As clearly stated in various recent reports of international organizations and particularly in the report of the Global Commission on International Migrations (GIM), "Governments and employers should jointly review current barriers to the mobility of highly educated personnel, with a view to removing those which are unnecessarily hindering economic competitiveness" (GIM, 2005). This same report identifies the dilemma that has existed between private enterprises and governments. While enterprises have recognized the necessity of international deployment of talents, policy makers have been constraining this process. According to this same source, the ten world largest corporations employ more than three million workers without consideration of national origin. This is related to the important contributions of foreign workers to corporate and global competitiveness. The report recommends that emigration of skilled labor be regarded as a choice provided to professionals and that this approach be shared by governments. Given the strong link between migration, education and knowledge, it is also important that access and freedom of choice be generalized at all the environmental conditions in source countries, starting with education and knowledge.
The mechanisms for providing access to education and to knowledge that are prevailing in developing economies do implicitly exhibit discrimination among potential beneficiaries and users. This implicit discrimination concerns directly the above sectors but is indirectly at the origin of dissymmetry in access to other basic social and economic services that include health care and other components of decent living conditions. These indirect effects do not favor, in return, the access to education and to knowledge. This implies that the major constraint resides in this implicit discrimination and its indirect and induced effects. All developing countries have had elites that have been contributing to both development and have been emigrating elsewhere. Both the stocks and the annual flows of these elites are very limited. Some individuals and groups have been largely contributing to different components of worldwide development but these elites can be seen as exceptions. This is the era where every individual could be a member of a largely educated national society; and can contribute when necessary to international development including through emigration. Natural and "laissez faire" selection cannot any more be the driver for the valuation of human resources. Means to reduce school

drop outs and instruments to be more inclusive are more than necessary in this exercise of knowledge generalization. All jobs are the same and all the skills are needed to ensure development with a humane dimension. Under these conditions, individuals and groups can have larger choices and larger capacities to exercise and implement their choices including the decisions to emigrate, stay or return to the source country.

Conclusion

It is expected that globalization and world development to be likely increasing the rates of emigration from developing (South) to developed economies (North) unless growth and prosperity take place in most countries of the South. Even under the optimistic scenario of further growth and development in the South, individuals and groups enjoy the freedom of mobility if they have larger opportunities to choose from.

Within this context, skilled labor migration takes place and generates consequently higher benefits for individuals, groups and communities but also to both the source and destination countries. The benefits to the sending countries are monetary but also non monetary as they are expressed under direct and indirect benefits of emigration. Remittances are not the only benefits but knowledge and experience besides the direct impacts on the enhancement of education and research in the source country are major sources of gains. This type of emigration was considered to be a brain drain but the new economics on migration has identified that is a brain gain.

The two objectives of this report were to reveal the determinants of skilled labor migration and to assess empirically the impacts of this migration from the available and accessible data.

The existing large literature on different dimensions of skilled labor migration has helped set a selection of the theoretical grounds needed for the empirical assessments. Some previous studies have also helped in the identification of the determinants. For the impact assessment, the models selected are within the generation of new economics of skilled labor migration. The models of Beine &al, Stark & al and Nguyen besides that of M. Schiff have been explicit both theoretically and possible databases identified for the empirical estimations.

The results obtained have confirmed the relevance of series of variables that are related to economic, social and political dimension of the economies. Much of the time, these variables are represented as differences between the situation in developed and developing economies. Some of the recently established indices such as those related to knowledge, corruption perception and openness of the economy have been useful in the estimation of the determinants of skilled labor migration.

Concerning the impacts, each of the above models in explaining the existence of brain gains throughout the sample of developing economies is retained. This brain gain is mainly represented as a stock of human capital that can vary depending on the emigration rate. It is also empirically related to the situation prevailing in the source economy. The newly established indices and mainly the knowledge economic index and some of its components have been instrumental in testing the relevance of the Stark & al and Nguyen models.

The policy discussion implied by the above results includes both the promotion of development in each source country with emphasis on education, knowledge and freedom of access to these domains besides to emigration as a choice.

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PART TWO: LABOUR MARKETS IN EUROPE AND IN THE SOUTH AND EAST MEDITERRANEAN COUNTRIES

CHAPTER 3: Varieties of Capitalism and Governance of Labor Markets in Europe

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In Western Europe, two principal phenomena characterize the state of the labor and employment field since the beginning of the 1990's:

- Firstly, disequilibria of labor markets, measured approximately by the unemployment rate, have reached levels not seen since the Great Depression of the 1930s. Therefore, there is the lingering question of an eventual 'Euro-sclerosis', i.e. the existence of a structural incapacity of Europe to create enough jobs to ensure and support the right to work.

- Secondly, the new stepping-stones of European construction, i.e. the adoption of the Maastricht (1992) and Amsterdam (1997) treaties, have opened a debate on the operational modes of heterogeneous labor markets in a unified economic space.

For the interpretation of these two phenomena, there are two conflicting schools of thought. These two conflicting conceptions of what is a labor market are:

- The standard (neoclassical) approach applies its general conception of markets to labor. In terms of employment policy, its normative recommendations are logically that every reinforcement of competitive mechanisms (the so-called 'flexibilization' or 'deregulation' of labor markets) brings the market closer to equilibrium and economic optimum. This way of thinking was clearly dominant from the beginning of 1980's to the end of 1990's, notably in the recommendations of international institutions (for instance, OECD, 1994).

- Another conception, which may be called the 'institutional approach', studies the functioning of markets as the result of a set of rules, norms, conventions, or institutions that guarantees a social regulation of the conditions of exchange. The main goal of this approach is to analyze and display vectors of coherence or contradiction in social compromises, which are considered temporary and evolutionary in relationship with global economic and social dynamics.

The taking into account of the role and importance of institutions in labor market dynamics now largely extends beyond the intimate circle of heterodox traditions and is henceforth part of standard analysis. Thus, the debate on the interpretation it is possible to give of the two phenomena mentioned above is not done any more in terms of a discussion about the vices and virtues of deregulation. It has shifted to take today the form of a controversy over the possibility of defining, from an economic point of view, a unique optimal and efficiency set of institutions that corresponds to the present state of economic dynamics, and which then must be adopted by economies whose goal is to remain competitive and dynamic in the age of the knowledge economy.

Our method will be the following:

- In a first part, we will recall that behind the overall bad performance of the European economy as a whole in the fight against unemployment, it is possible to spot among European countries some 'success models' (and even some 'resistance models'). Thus, a first fact we shall have to bear in mind is the great diversity of national achievement in overcoming mass unemployment.

- In a second part, we shall question whether this factual diversity of national performance can really be so easily associated with the diversity of national labor market regulations. We shall see that this **is not the case** and that **it appears impossible to establish a simple and direct link between labor-market performance and institutional features** and modes of governance characterizing the various European economies. We shall stress particularly that among 'success models' great differences remain in institutional practices and thus, it appears definitively established that **it is impossible to describe what ought to be the 'one best (institutional) way' to return to full employment.**

- Quite the reverse, we will infer the existence of an irreducible variety of capitalisms from this first statement; that is, of a multiplicity of possible ways to coherently institutionalize and organize market economies. There are obviously several 'roads' to success. We will then voice the hypothesis that institutional choices for a large part thrust their roots into historical, cultural and political currents. This is a way of pointing out the limits of benchmarking in this domain and the impossibility of hoping to import the 'best institutional practices'. There are definitely no 'best (universal) institutional practices' (i.e. that are independent of cultural, political and historical determinants).

- We will then conclude with scenarios remaining open for the European economy's future and especially for the European Employment Strategy.

3.1: Europe Facing Unemployment: the Overall Picture and National Achievements

As we shall see in section 3.1.1, the persistence of an important level of unemployment in Europe is an established fact. This situation contrasts strongly with the American labor market, providing arguments for the hypothesis of a sclerosis particular to the European economy, perhaps associated with the inappropriate institutional structure of its labor markets.

Then, in section 3.1.2, we complete the survey of the main stylised facts, recalling that the global situation of persistent mass unemployment in Europe covers a wide range of performances among national economies, a diversity from which is difficult to draw clear conclusions about the 'best institutional practices'.

3.1.1: Stylized Facts: Unemployment and Economic Performance in Europe

A) Unemployment Rates

Whatever the chosen indicator, the global performance of European labor markets seems poor. This is especially the case if we compare Europe with the USA.

Disregarding cyclical evolutions, the unemployment rate has continuously increased in Europe from the beginning of the 1970's to the middle of 1990's (**Graph 1**[6]). From this period onward, one can observe a decrease (OECD, 2006), but which is perhaps mainly due to the improving worldwide conjuncture at the end of the 90s and without any guarantee for the future in terms of unemployment during the present phase of the business cycle.[7] During the 1990's, from 1990 to 1997, the unemployment rate rose in Europe by 2.3 points, while it fell by 0.6 points in the United States. Over the 1990 to 2000 period, it remained constant in Europe, while falling by 1.5 points in the United States. The same result is apparent over a longer term: from 1982 to 2000, the unemployment rate in Europe remained constant; whereas, it diminished by 5.5 points in the United States. Finally, over the long term, one can observe that the rate of unemployment in the United States remained the same in 2001 as it was in 1970; over the same period, the unemployment rate rose by 5.5 points in Europe.

B) Employment Rates

The same superiority of the American economy is apparent in job creation, as indicated by the employment rate. Indeed, the employment rate is a very global measure of the ability of an economy to create jobs. For instance, this indicator permits the distinction between two economies that obtain the same results in terms of the unemployment rate - but one by creating jobs, the second by reducing the level of the active population (by means of 'Malthusian' policies such as financing early retirements). It is well-known that henceforth this indicator is considered central in the recommendations of international institutions (such as the OECD or the European Commission), which insist on measuring the performance of labor markets by means of employment rates (rather than by unemployment rates) and then define well-oriented employment policies by their capacity to 'activate' employment expenditures (which means specifying the goal of improving employment rates rather than settling for a reduction of unemployment rates).

One can observe in **Graph 2** that the employment rate has continuously increased in the United States, finally reaching 76% in 2000 (and 71.5% in 2004). On the contrary,

[6] Please turn to the graphs in Annex.

[7] This is in spite of the fact that the lowest point reached in 2001 (7.4% of average unemployment in Europe), lower than points reached during the precedent cycle (8.3% in 1990), could indicate a reduction in structural unemployment.

European economy did not experience an increase in its rate of employment, which remained between 1970 and 1994 of a remarkable stability (59% in 1970 and 59.9% in 1994). Only the last decade posts a continuous progression of this rate, which reaches 64.9% in 2004.

C) Total Hours Worked

Even if we accept the idea that economic efficiency is just a matter of creating employment, the ideal way to truly evaluate the capacity of an economy to create employment is to examine the evolution of the volume of labor (as measured by the number of hours worked), whatever the way this volume is divided among the number of jobs and the hourly duration of work. Thus, **Graph 3** that plots the evolution of total hours worked in the United States and the EU since the beginning of the seventies illustrates two key facts:

- First, the total volume of labor carried out on both sides of the Atlantic Ocean grew, from nearly 400 billion hours worked in 1970 to 500 billion today.

- This increase was concentrated in the United States, where the volume of labor increased from 150 to 250 billion hours worked, which is to say an average annual increase of 1.43%; whereas, the volume of labor in Europe remained constant at roughly 250 billion.

Consequently, these facts would seem to reinforce the previously mentioned impression of European economic sclerosis, while the United States undoubtedly appears to be the 'great Job Machine'.

D) Productivity and GDP per capita

As it is well known, since the times of Adam Smith, improving the *volume* of labor is not, in itself, a sign of economic efficiency (and of ability to improve wealth and well-being), but this also depends on the *quality* or *productivity* of labor. So, we have to look at the evolution of the respective labor productivity in the United States and in Europe to really measure relative economic efficiencies.

As it happens, if we are interested in the evolution of productivity per hour worked from the beginning of the seventies to today (**Graph 4**), we can indisputably observe that European economy's productivity has caught up with the productivity of the United States' economy at least until the middle of the 1990's. Productivity per hour worked in Europe represented only 56% of that observed in the United States in 1970; however; by 1995, European performance was equal to the performance of the United States.

So, productivity has increased in Europe faster than in the United States. Indeed, labor productivity in Europe has increased, in average on that period, by 2.6% per year, whereas it rose only by 1.7% in the United States. Finally, labor productivity has more than doubled in Europe from 1970 to 1995, whereas it increased only by 43% in United States.

If we remember that the GDP in the United States and in Europe are quite the same[8], and that, in the long term, they increase at a similar, average rate, we can interpret what we have just above-reminded about the relative profile of productivity in the two economies, as illustrating what it is used to call the "productivity dilemma".

Indeed, it is possible to say that Europe has reached, in the long term, a quite similar growth as in the United States, with a constant Labor expense, whereas it increased in the United States by more than two-thirds. Such an observation could lead us to conclude, unlike our previous statements, that European economy is remarkably efficient, and that, consequently, the institutional frame of its labor markets doesn't have to be challenged, since it has not prevented the powerful catching up of productivity we have just above described.

More seriously, these facts remind us that productivity growth can alternately be deemed as undesirable (in the short term, and in the presence of mass unemployment), or desirable (when the economy is in a situation of full employment, and when consequently productivity growth is the only way for the economy to improve its ability to create wealth and well-being). Thus, the rate of productivity growth defines "potential" growth of an economy (*ceteris paribus*, i.e. for a given growth rate of active population). The labor content (measured in hours worked) of a given effective growth rate is then greater, while the potential growth and, thus, the productivity growth is smaller.

If we turn now to the efficiency of economic models as measured by the wealth per capita, one observes the superiority of the American economy compared with the European economy (**Graph 5**). Clearly, the process of catching up seems interrupted since the beginning of the 1970's, and the GDP per capita in Europe stagnates between 70% and 75% of what it is in the United States. Above this general trend which exhibits a relative stagnation of the European economy, one can also note the obvious influence of macroeconomic shocks which have affected the European economy. Then, the above mentioned interruption of catching up has to be dated more from the beginning of the 1980's than from the beginning of the 1970's. The setting up of restrictive counter-inflationist policies in Europe has been, from that point of view, decisive. Since that time, the relative level of GDP per capita in Europe has grown during each period of boom, but without ever gets to exceed the percentage of 75% (**Graph 6**). Then, it is already possible to note that, beyond the strict taking into account of institutional and structural features of European Economies to try to explain their relative bad performances, we don't have to forget the importance of macroeconomic dimension of the problem, and the very decisive influence of macroeconomic policies orientation, even in the long term.

3.1.2: The diversity of performance in Europe: models of success and others

In the spirit of Fitoussi and Passet (2000) or Freyssinet (2000), we believe it is interesting and necessary to examine the various national situations. In this way, it will

[8] In 2006, GDP of USA was 13 185 billions of dollars, whereas GDP of EU was 14 255 billions of dollars (at current prices and exchange rates) (source: OECD, *Main Economic Indicators 2007*)

be possible to distinguish the countries that have succeeded in their fight against mass unemployment, even in Europe, or that have never experienced it. Then, we will be able to attempt to associate the eventual performance with an identifiable institutional framework and, more generally, with a particular mode of governance of labor markets.

In their work, Fitoussi and Passet distinguished six different medium-term trajectories and, studying unemployment patterns during the 1990's, chose to associate each unemployment situation with one or the other of these paths, thus classifying the European countries into the six different groups below.

Six years later, what has become of this classification? We can examine the current position of the different European economies between 1990-2001[9] and in 2002[10] (**Graph 7**). We, then, can clearly distinguish two groups: the first comprises of countries still suffering from mass unemployment: Spain (11.5%), Finland (9%), France (9%), Italy (9%), and Germany (8.6%); a second group comprises of countries enjoying a low level of unemployment: Sweden (5.2%), the United Kingdom (5.1%), Portugal (5.1%), Denmark (4.7%), Ireland (4.2%), Norway (3.9%), and, finally, the Netherlands (3.1%).[11]

If we now, *à la* Fitoussi and Passet, try to place these current positions with respect to medium-term trends, we find roughly the same ranking as they did (**Graphs 8**), except for Spain which seems hard to fit within the group of continental European economies. Like these countries, Spain obviously still suffers a high unemployment rate and should be classified in the group of economies with 'persistent mass unemployment'. However, the medium-term trend experienced by Spain in fighting unemployment, with the passing of time, seems notably different and prompts us to move it closer to the first group which is made up of economies enjoying a trend of continuous decreases in the unemployment rate over the medium-term.

In the same manner, we turn our attention to the two Nordic countries, Sweden and Finland. Fitoussi and Passet place them both in a separate group of countries that suffered a sudden rise in unemployment at the beginning of the 1990's, disturbing their effort to overcome unemployment. This contrasts strongly with the precedent decade during which their economies had managed to avoid any major labor-market imbalances. Here, again, with the passing of time it becomes possible to doubt the pertinence of this classification. The rupture did of course occur and did negatively impact the two countries. As a consequence, the current level of unemployment did increase upward. In the case of Finland, the unemployment rate fell from an average 4.66% in the 1980's (Sweden's average rate was 2.68%), touching a trough in 1990 at 3.1% (1.6% in Sweden) before exploding to 16.4% in 1994 (Sweden: 10.2% in 1997), and finally leveling off in 2002 at 9% (5.2% for Sweden).

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[9] 1990 and 2001 were 'low points' of the cycle in terms of unemployment.

[10] 2002 was taken as the 'final' position reached at the end of the cycle. Since that date, and over the last four years, unemployment rates generally begin to increase again.

[11] To complete the picture, we could add that at that date these countries experienced relatively high levels of employment rates: 76.1% in Denmark and Norway, 73.5% in Sweden, 73.4% in the Netherlands, but also 73.1% in the UK and 72.9% in Portugal. Ireland alone is not situated much above the European average (65.9% against 64.3%) from this point of view. Moreover, Norway enjoys a high level of GDP per capita, similar to the figure for the USA.

We would, however, stress two facts. Clearly, even if these two economies experienced a similar path, unemployment in Finland was worse than in Sweden over the period studied. This explains why Sweden, with a current unemployment rate of less than 6%, can be classified in the group of 'success models'; whereas Finland, with an unemployment rate of more than 8%, must be placed in the group of 'bad pupils'. The main point is not there however: examination of the medium-term pattern of the two economies shows that they both seem again in position to return to a low level of unemployment[12]. Finally they could prove not to be far away from the group of other Nordic Countries.

In summary, we can establish two principal country groupings for the sake of simplicity. On one side, we can group economies enjoying a low level of unemployment today, whether they reached this state by recovery from a dynamic and/or continuous fall ('dynamic models'), or whether they never suffered any major imbalance in their labor market ('models of resistance'). We find here: Ireland, the United Kingdom, Portugal, and the following Nordic countries: Norway, Denmark, and the Netherlands. On the other side, we find countries having not yet succeeded in their attempt to overcome mass unemployment. This group is made up of the 'big' continental economies: France, Germany, and Italy. Finally, there are three countries that do not easily fit into this ranking: Spain on the one hand, Sweden and Finland on the other. Their current situation brings them closer to the last group, but the dynamics of their situation could soon lead us to place them in the group of successful economies.

We now come to our main point: whether or not it is possible to establish links between the diverse national achievements in reducing unemployment and the variety of institutional frameworks and modes of governance (including employment policy contents) of the different national labor markets. As we shall see, this is far from being a simple matter.

	DECREASING UNEMPLOYMENT	*PERSISTANT TREND*	*BREAK*
MASS UNEMPLOYMENT	Spain	France, Germany, Italy	Finland
LOW LEVEL OF UNEMPLOYMENT	United Kingdom, Ireland, Netherlands, Portugal, Denmark	Norway	Sweden?

[12] This is not yet the case for Sweden because the unemployment rate has risen over the last four years, having, it would seem, a non-negligible influence on the result of recent elections, which were lost by the Social Democrat Party.

3.2: Institutional Diversity of European Labor Markets

A widely held view during the 1980's and 1990's was that bad European performances in the fight against unemployment must be linked to institutional features of European labor markets making them too 'rigid' in comparison with what should be a self-adjusting, purely and perfectly competitive market. International organizations such as the OECD (Organization for Economic Co-operation and Development) and the IMF International Monetary Fund), in particular, were promoters of this theory.
Since the relatively bad average performance of Europe taken as a whole masked in reality a wide diversity of national achievement in overcoming unemployment[13] such a theory should lead us to clearly identify 'good' institutions (those that facilitate a high level of employment would therefore characterize governance of labor markets in 'models of success') and 'bad' institutions (those preventing self-adjustment of labor markets being systematically present in countries still suffering high levels of unemployment).

As we demonstrate in this section, the real world is more complicated. We can indeed point to the great variety of labor-market institutional frameworks in Europe. However, it is impossible to establish an objective relationship between institutional features and the ability to overcome unemployment. In other words, it is difficult to identify the best institutional practices using this approach, and we must give up the myth of a 'one best way' of reforming labor markets. We are, on the contrary, led to taking into account the irreducible varieties of capitalism and, therefore, of the multiplicities of the 'roads to success'.

3.2.1: The Institutions of Labor Markets and their Diversity in Europe

Three main institutional dimensions are generally studied: (A) the employment protection legislation, (B) the modes of wage bargaining (including minimum wage legislations), and (C) the nature of employment policies (particularly the respective importance of unemployment benefits systems and active labor-market policies).

A) The Varieties of Employment Protection Legislations (EPL).

1. Definition and potential impact

[13] Cf. Lavialle (2006).

An employment protection exists if an employer is not able to use some particular form of labor organization or work contract, even in accordance with his employees, without risking legal sanctions or invalidation of the clauses of the contract in question.

A priori, such legal protections could have two types of consequences on the labor market. First, employment protection modifies the extent and speed of the *quantitative* adjustment. Indeed, such regulation, for instance in the form of the costs of hiring, training, and firing, determines an insensibility zone of the *level* of employment to economic activity.

Secondly, regulation could impact *qualitative* adjustment. It, indeed, influences the *structure* of employment, encouraging other specific employment forms, which are less regulated and/or more flexible.

2. Evaluation and results

The strictness of the EPL is hard to evaluate. We certainly have to take into account several aspects of regulations: rules of hiring and of dismissals, differentiation between permanent and temporary work contracts (and the associated costs), regulations of working-time, restrictions on some types of work (night work, shift work, weekend work). Furthermore, effective constraints depend not only on employment legislation, but also on jurisprudence or collective bargaining.

To build a synthetic index that would permit the measurement of the degree of EPL strictness, the method henceforth employed by OECD consists of attributing a score to a complete set of indicators, which are then weighted and aggregated to three main components. This method leads to the measure of an 'overall summary index', according to which the EPL strictness is evaluated on a scale from 0 to 6. Confining ourselves to the countries that we have chosen to consider in this study,[14] we can represent the EPL strictness in each country as in **Graph 9** (Countries are ranked from left to right in ascending order of the overall summary index).

We can observe the great variability of EPL among European economies. In the 1980's, employment was strictly controlled in the Southern European Countries, in most of the analyzed aspects of regulation, and, conversely, it seemed unregulated in the United Kingdom and Ireland (Grubb and Wells, 1993). For the other countries, some aspects were strictly controlled, while others were not. In this case, it was difficult to establish a clear diagnosis about overall EPL strictness. At the end of the 1990's, the same ranking still existed: the United Kingdom, Ireland, and Denmark, like the United States, had the least strict legislation; whereas, the Southern European Countries had the strictest (OECD, 1999). Finally, in 2003, we find again the same hierarchy. Relative positions of countries have remained globally the same, despite a slow convergence trend since 1994.

Particularly, the five European countries (the United Kingdom, Ireland, Denmark, the Netherlands, and Norway) that now enjoy a low level of unemployment (let us say less than 5% in 2005) obviously have very unequally strict employment protection legislation

[14] From this point on, we add the case of Poland to enlarge our screen to transition countries.

today. It is (very or relatively) lenient in the United Kingdom, Ireland, and Denmark, and moderately lenient in the Netherlands and Norway. Furthermore, among economies that have experienced a decrease in the level of their unemployment, some are still characterized by a relatively strict EPL (Portugal and Spain for instance).

In summary, it seems that EPL strictness does not have a great impact on the global level of unemployment. Most empirical and econometric studies have moreover confirmed this conclusion – for example, the recent work of Bassanini and Duval (2006). However, if EPL strictness does not have influence on the *level* of unemployment, it does have some impact on both the *structure* and the *duration* of unemployment. Indeed, a stricter EPL goes hand in hand with lower job and workforce turnover (Passet and Jestaz, 1998). One could thus put countries with high job turnover and more flexible EPL (Denmark, Ireland and the United Kingdom) beside those with low turnover and stricter EPL. Among the latter, the weakness of inflows and outflows in the labor market characterizing them tends to increase unemployment duration (Blanchard and Portugal, 1998), and thus the proportion of long-term unemployment in global unemployment. Furthermore, most econometric studies (cf. OECD, 2006, chapter 3) stress the fact that EPL could have some impact on labor-market performance by way of its interaction with macroeconomic shocks (cf. Blanchard and Wolfers, 2000). The resilience to such shocks could be greater in the case of low turnover and could facilitate the emergence of what are generally called 'hysteresis effects' in the trend of equilibrium unemployment.

This point leads us to another. A strict EPL, lowering turnover in the labor market, tends to reduce possibilities of being hired for those groups having the greatest difficulties finding employment, and which are, for that reason "outside" the market: young people, women, long-term unemployed… However, a negative macroeconomic shock could suddenly increase the number of such labor-market "outsiders". The equilibrium rate of unemployment could thus increase, and that definitely, if the institutions of Labor market don't authorize those outsiders to return to employment quickly, after the shock is passed off. In this case, for instance, hysteresis could result from long-term unemployed human capital becoming obsolete.

Finally, a strict EPL could lead to a segmented labor market, separating protected regular workers from the other groups, on which workforce turnover concentrates and which become trapped in a sequence of insecure jobs. This is particularly the case when the EPL of permanent work contracts remains strict while being softened for temporary forms of employment.

3. Policy recommendations

In the light of both empirical and econometric studies and of recent reform experience in several European countries (Austria, the Netherlands, and Denmark…), lasting recent years the debate over the best way to reform EPL has focused on the advantage of attempting to conjugate flexibility (i.e. a less strict EPL, perhaps favourable to both the employers in the management of their workforce and to the worker 'outsiders' on the labor market, whether they be unemployed or trapped in precarious professional careers) with security (protection of the employees from unemployment, precariousness or social exclusion). The idea then is to:

- Reinforce EPL efficiency whatever the level of strictness (which, as we have seen, is not a determinant factor in the fight against unemployment), reforming its implementation in such a way as to become more rapid and predictable for employers and less discouraging to workforce turnover,
- Coordinate EPL with others dimensions of employment policies such as, in particular, unemployment benefits systems and labor-market activation policies.

With this in mind, the recent experience of Denmark is often held up as a good example because of their policy combining:

1. A moderately strict EPL, resulting in relatively high worker mobility, a high turnover rate (cf. Bingley *et al.*, 1999) and one of the lowest average professional seniority figures appearing in comparative international statistics (cf. OECD, 2001, chapter 3),
2. Relatively high unemployment benefits, assuring economic security for the unemployed and giving them time to search for and find a new job that meets their expectations as far as possible, and
3. Strong 'activation' measures to prevent the potential negative effects of such a generous unemployment benefit system such as the disincentive to work.

In the end, this system of flexibility and security, or 'flexicurity system', seems to have succeeded in associating a 'liberal' EPL (and thus both flexibility for firms and substantial workforce turnover, preventing the possible formation of a dual labor market) with great sense of security for workers, (ensured by a high level of expenditure for employment policies (see below), securing both large unemployment benefits and the efficient accompaniment of the unemployed).

This point leads us now to the study of other characteristic institutional features of labor markets: the varieties of wage bargaining regimes and minimum wage legislation.

B) Varieties of Wage Bargaining Regimes and Minimum Wage Legislation

Two types of institutional devices under the microscope are wage-bargaining regimes, on one hand, and minimum wage legislation, on the other.

Clearly, the analytical *a priori* on the subject is that any institutional mechanism resulting in a lower sensibility of wages in reflecting labor-market imbalances will be unfavourable to employment. Then, as we shall see, there exists in the standard approach a prevention against non-decentralized bargaining regimes (because of their distance from the productive reality of firms and because of their divorce from the way competitive labor markets should function) as well as a prevention against the creation of a minimum wage legislation (which obviously introduces price rigidity on the market).

Here again, stylized facts as well as empirical or econometric studies have led over time to a reassessment of policy recommendations, taking into account the great diversity of institutional frameworks among European labor markets in a less instrumental way – and, what is probably most important, even among 'models of success' in overcoming unemployment.

1. Definition and potential impact of wage-bargaining regimes

Since Calmfors and Driffill (1988), wage-bargaining regimes have been characterized by their degree of centralization. This indicator refers to the formal structure of bargaining and leads to the distinction of three different levels: wage bargaining could even take place at the national level (centralized systems), at the level of an industry or a profession (intermediate systems), or finally at the sole level of the firm (decentralized systems).

Moreover, regardless of the level at which bargaining formally takes place, the output of bargaining also depends on the informal degree of coordination between social partners, which refers to both the degree of coherence between the different levels of bargaining and to the existence of a consensus between social partners about the aims they should pursue. From that point of view, Soskice (1990) considers that a strong coordination of these two levels is equivalent to formal centralization. The three distinctive bargaining systems could be characterized as follows: centralized and/or coordinated systems, decentralized and uncoordinated (or little-coordinated) systems, and 'others', which are described as intermediate systems.[15]

In addition, one has to take into account the *true* influence of the bargaining regime, which now depends on the unionization rate and/or on the formal coverage of collective agreements.

The relation between bargaining systems and labor market performance depends on the relative importance of two effects: external effects[16] and competitive effects.[17]

Logically, both centralized and decentralized systems can be efficient. Centralized systems can be efficient because the internalization of external effects can more than offset the increase in trade-union monopoly power and the decrease of competitiveness in goods markets, while decentralized systems can be efficient because competition in goods markets can limit external effects since decentralization permits bargains that are more thorough and closer to the firm's productive reality. Along these lines, Calmfors and Driffill (1988) demonstrate the existence of a 'ring curve', illustrating the fact that both decentralized and centralized bargaining regimes lead to good performance in terms of wages and unemployment; whereas intermediate systems cumulate the inconveniences of the two extreme regimes, precisely because they are 'intermediate'.

[15] When we attempt to rank countries according to one dimension only, imprecision is recurrent: we are able to define two opposite 'poles', and all countries that cannot easily be ranked and identified with one or the other pole end up belonging to an 'intermediate case' along the axis. This inconvenience is clearly the consequence of a too instrumental and linear view of the impact of institutions and of ignoring the systemic character of their relations.
[16] The concept of external effect brings us back here to the fact that a bargained wage increase could result in a price increase, followed by a lower real wage for those workers who are not concerned by the initial bargaining (and thus by the wage increase).
[17] See Cahuc and Zylberberg (2006) for an extensive survey of wage-bargaining models.

They are not centralized enough to overcome external effects and not decentralized enough to be disciplined by competition in the goods markets or to reduce trade-union monopoly power.

By adopting the summarized presentation of ranking constructed by the OECD,[18] the great diversity of institutional practices can also be observed (cf. below).

Among the 'models of success', centralization and/or coordination remain strong in Denmark Ireland, Norway, the Netherlands, and Portugal. Within the group of successful economies, the United Kingdom, characterized since the 1980's by an extreme, low-low bargaining regime (low centralization and low coordination), thus appears to be more of an exception than a model setting the rule.

Moreover, following Calmfors and Drifill, it seems confirmed that the worst system is the intermediate one because of the exercise of a type of monopoly (or duopoly) power by trade unions that is not balanced by the capacity to self-discipline wage claims, whether under the pressure of competition or by sharing macroeconomics constraints. We find the countries France (over the three periods), Italy (but not in the last period), Spain, and Sweden (since the 1980's) in this group.

Coordination Centralization	STRONG	INTERMEDIATE	LOW
STRONG	**70's**: Dk, Fl, Irl, Nw, Ptl, Sp, Sw **80's**: Fl, Nw **90's**: Fl, Irl, Ptl, Nw		
INTERMEDIATE	**70's**: Ger **80's**: Ger, Dk, Nth **90's**: Ger, Nth, It	**70's**: Fr, It, Nth **80's**: Fr, It, Ptl, Irl, Sp, Sw **90's**: Fr, Sp, Sw	
LOW	**70's**: **80's**: **90's**: Dk	**70's**: UK **80's**: **90's**:	**70's**: **80's**: UK **90's**: UK, Pl

If we look particularly at the evolutions, we clearly see that after a move toward decentralization (and sometimes de-coordination) during the 1980's (probably under the pressure of policy recommendations from international institutions), the 1990's witnessed a comeback, not necessarily to centralization, but to greater coordination.

The examples of Denmark and the United Kingdom remain noteworthy. Denmark has systematically pursued its decentralization evolution, while keeping a high degree of coordination. As we have mentioned, the United Kingdom is the only country going against the general trend, retaining its 'liberal' strategy even after the return to power of the Labor Party.

[18] OECD (2006). See also Lavialle (2006).

Finally, the examples of the Netherlands and Ireland, and also the capacity of Germany to withstand macroeconomic shocks (at least until the beginning of the 1990's), are there to remind us that coordination between social partners has a great favorable impact on the capacity to overcome unemployment. It is the case notably because such coordination authorizes, firstly to establish a shared diagnosis about the situation and its determinants, then to articulate in a cooperative way macroeconomics arbitrations and wage bargaining.

So here, too, at least two types of 'good (institutional) practices' can be distinguished. As the OECD (2006) remarked, one would be well-advised to take more widely into account the fact that mechanisms and practices characterizing professional relations in each country are part of their political and social structure, and that it is consequently difficult for governments to reform them. Moreover, it appears that the efficacy of such mechanisms and practices depends also on their coherence with this political and social context.

2. Definition and potential impact of minimum wage legislation

For a long time, minimum wage has been considered one of the main labor market institutions causing mass unemployment in Europe, even if minimum wage legislation exists elsewhere (Japan, Canada, and the USA). Nevertheless, very few studies have in fact been devoted to analysing the impact of minimum wage legislation on employment from the standpoint of international comparisons, while it must be said that institutional features of minimum wage obligations are quite different from one economy to another.

The existing systems can be characterized by three criteria: the level of minimum wage, its modes of determination (legal, according to sectors), and its modes of indexation (automatic or discretionary). Here too, one observes a great diversity in institutional practices among European economies.

The minimum wage is set legally by the government in Spain, France, Portugal, and the Netherlands, as well as in the United Kingdom since it was reintroduced by Tony Blair's Labor Government. In Belgium and Greece (not represented in the table below), there also exists a minimum wage fixed at a national level, but through a collective agreement. Everywhere else, the minimum wage is fixed by sectors and, in these cases, the situation is more difficult to appreciate.

Depending on the various modes of indexation, the level of minimum wage and its evolution differ from one European country to another. However, taking all elements into consideration since the mid 1970's, after an initial period during which levels of minimum wage fell (Spain, Greece, Portugal, and the Netherlands) or even minimum wage legislation itself was abolished (the United Kingdom), the recent period shows a global tendency to maintain or even reintroduce minimum wage legislation (the United Kingdom and Ireland) and to maintain its legal level (except in Spain). In Europe, it is in France, which traditionally uses the minimum wage as a legal tool to impulse purchasing power and consumption dynamics, that the labor cost for minimum-wage workers relative to median-wage workers is the highest.

However, it is not possible to draw a unique theoretical conclusion about the impact of wage legislation on employment. Bassanini and Duval (2006) show that there is no significant affect of the minimum wage on global unemployment, even if the employment rate of young people seems weaker than the higher the level of minimum wage.

	Date	Modes of Fixing	Modes of indexations	Level: *Ratio of employers' labor costs for minimum-wage workers relative to median-wage workers (in %)*[b]		
				1997	2000	2004
Spain	1963, 1976	Legal	Prices and Economic performances	33	21	19
Ireland		According to sectors		-	40	39
Poland				45	41	40
Portugal	1974	Legal	Prices and Economic performances	43	46	44
United Kingdom	1909-1993, 1999	According to sectors Legal	Non automatic	-	42	44
The Netherlands	1968	Legal	Average wage, with possibility of suspension	48	50	51
France	1950 1970	Legal	Prices and, for a part, wage rate per hour. Possibility of discretionary boosts	55	55	54

-: Not applicable.

a) Gross wage payment plus employers' mandatory social security contributions, using as a proxy employers' contribution rates for a single worker with no children at the 0.67 average production-worker earnings level.

b) Countries ordered from lowest to highest relative cost of employment minimum-wage workers in 2004.

Source: OECD (2006)., CSERC (1999), IRES (2000) .

Moreover, as the OECD has now recognized (OECD, 2006), because the impact of minimum wage legislation, although still centered on employment, appears nil or modest on the employment level, it might be useful as a tool for social policy aimed at overcoming poverty. A minimum wage indeed encourages activity and work, making work financially appealing for low-skilled workers or basic welfare benefits holders (making work pay!). In the same spirit, minimum wage is a safeguard preventing the possibility for an employer, in the situation where a minimum wage is paid in complement to an activity benefit, to reduce wages so as to appropriate these benefits (Gregg, 2002), even if the existence of thresholds can raise the question at higher wage levels (the possibility of drawing concurrently a salary and an activity benefit – negative taxation – encouraging appearance of low wage traps).

To sum up, here too the true impact of an institutional feature that might be judged *a priori* as introducing an element of imperfection and of rigidity, in what would otherwise have been a freely competitive and self-adjusting market mechanism, finally must be interpreted in a quite different manner: it may be considered as a possible element of a coherent institutional framework.

C) Varieties of employment policies: unemployment benefits system and active labor market policies

Public employment policies aim to influence the volume and the structure of employment, unemployment, and the active population.

Two types of employment policies can be used. Active employment policies correspond to measures that aim to facilitate access to the labor market and to employment, as well as to improve vocational training and labor market functioning (the quality of matching mechanism). International institutions have, thus, strongly supported the development of such policies since the beginning of the 1990's.

Indeed, the main objective of theses policies is to improve the match between supply and demand on the labor market by the means of vocational training programs and improved efficiency in public service employment. If labor supplies are available more quickly, hiring costs diminish, which may encourage firms to recruit. Moreover, unemployment is a factor of diminishing productivity, causing human capital to become obsolete and the loss of work skills through long-term unemployment. A goal of active employment policies is precisely to improve labor productivity, or at least to diminish the impact of unemployment on productivity. Lastly, the final goal of such policies is to improve participation in the labor market, as can be measured by employment rates, more than to reduce unemployment rates. Unemployment could indeed decrease only because discouraged workers and old workers (benefiting from financed early-retirements mechanisms) may give up trying to maintain themselves in activity. It is the role of active employment policies to thwart such tendencies.

Conversely, passive employment policies refer principally to out-of-work income maintenance and support measures and to early retirements financing measures. They are generally considered disincentives to work and it is widely believed that a well-oriented employment policy must outweigh the role of active measures in the range of its interventions.

It is, thus, possible to rank European economies according to two criteria. One can first look at the importance (in volume) of their employment policies, measured by the level of public expenditures for employment policy as a percentage of GDP. Then, one can examine the structure of these expenditures to evaluate the relative importance of active and passive policies.

According to the first criterion, three groups can be defined:

- The first group is composed of countries spending more than 3% of GDP on employment policy programs, for example Denmark (4.49%), the Netherlands (3.67%), Germany (3.46%), and Finland (3.04%).

- Then, in the next group, we find economies where the percentage of GDP invested (or consumed?) in employment policies represents about 1.5% or less. In this group, we find Norway (but as we have seen, these economy have never suffered from unemployment), Ireland, Italy, and especially the United Kingdom (0.81%!).
- Finally, in the last group, we have an intermediate group whose level of public expenditure on employment policy is around 2% of GDP. These include countries such as France, Sweden, Spain, and Portugal.

	Public Expenditures for Employment as a percentage of GDP	*Active Policies as a percentage of Total Expenditures for Employment*
Denmark	4.49	40.78
The Netherlands	3.67	39.00
Germany	3.46	33.00
Finland	3.04	32.00
Sweden	2.56	49.00
France	2.69	36.00
Portugal	2.02	35.00
Spain	2.22	32.00
United Kingdom	0.81	64.00
Norway	1.65	48.00
Italy	1.35	44.00
Ireland	1.51	41.00

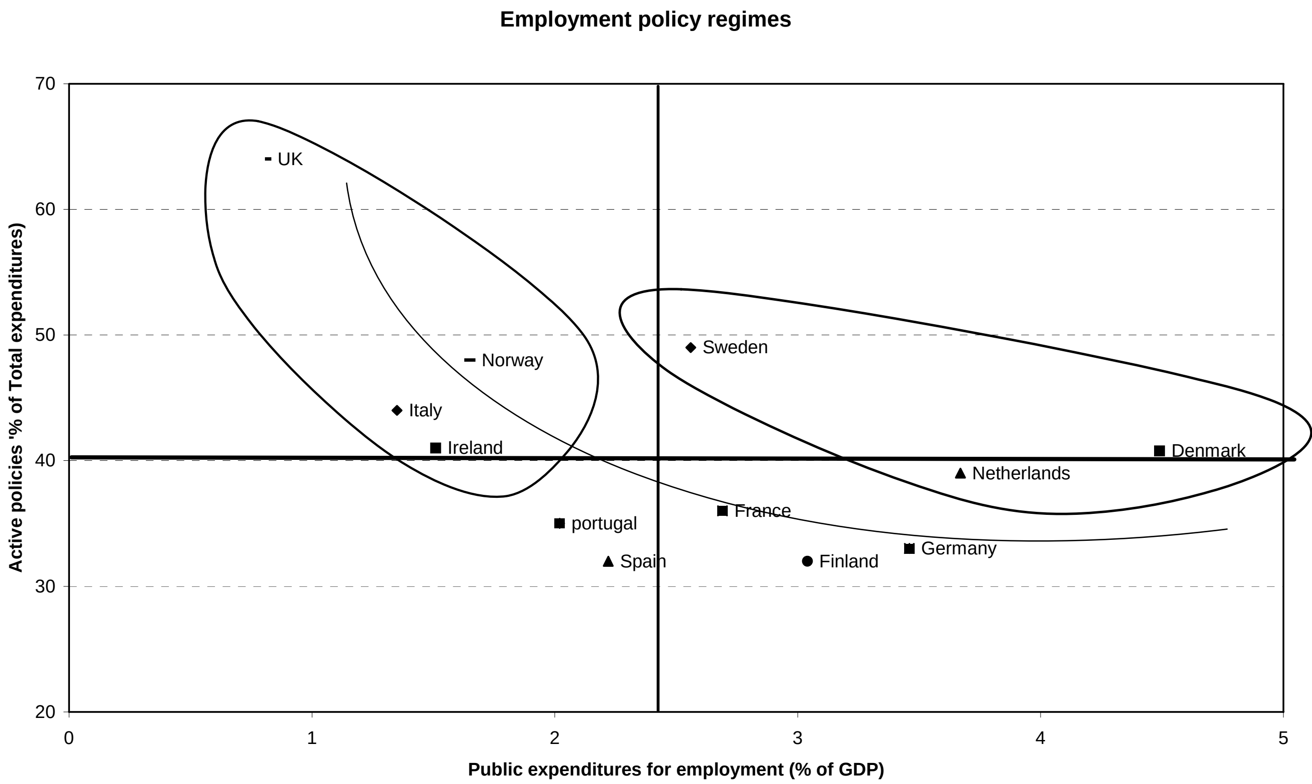
If we now look at the proportion of spending on active policies in the total volume of expenditures, we observe that, logically, economies with low levels of employment policy expenditure devote a high proportion of it to active policies. This is the case for Norway, Italy, and Ireland; but, here too and above all, it is true for the U.K. where 64% of employment policy expenditures finances active measures.

However, we can also find a quite similar 'performance' for active measures in public expenditure on employment in countries that spend far more. This is the case, among others, of Denmark and of the Netherlands in the first group defined above, but also of Sweden in the 'intermediate' group. The others devote around one third of their total expenditures to active programs.

Finally, it again seems possible to highlight two opposite employment-policy regimes.

The first is mainly represented by the United Kingdom, but also by Ireland and now Italy, where the improving 'activation' of public expenditure for employment is obtained by a reduction in size of employment policy, and particularly where the indemnity effort is very weak (the UK and Italy).

Conversely, the second employment-policy regime assembles countries in which the ‘activation’ of employment policy expenditures does not simply mean decreasing passive expenditures such as out-of-work income maintenance, but is attained by a systematic articulation of active and passive measures. Here we principally find Denmark and the Netherlands, but Sweden as well, even though its total level of expenditure on employment policies is lower.



The main point, again, is that it is not possible to establish a direct link between the type of employment policy regime and the ability to overcome mass unemployment. We find ‘models of success’, even in the first group (the United Kingdom, Norway, or Ireland), as well as in the other (Denmark, the Netherlands, and Sweden). This finding seems to confirm that the one best ‘institutional’ way to coordinate behaviors on labor markets and to regulate them does not exist.

3.2.2: Taking institutions into account: from the ‘best practices’ hypothesis to the ‘varieties of capitalism’ approach

A) The Varieties of Capitalism Hypothesis

The preceding analysis shows that institutional characteristics do not enable us to draw any distinction between the experiences of the ‘model’ countries and those of other countries.
Moreover, it appears that some ‘model’ countries display quite different institutional features. Neither the persistence nor the response of unemployment to macroeconomic shocks seems to be dependent in a simple manner on the structure of labor markets or on changes undergone by labor-market institutions.

Consequently, it is necessary to direct our attention to two other types of explanation.

It is essential not to forget the importance of macroeconomic policy in the performance of labor markets. Fitoussi and Passet (2000) illustrated the important role that macroeconomic policy seems to have played in most success models. In most instances during the 1990’s, these ‘models’ were characterized by a more expansionary policy mix than in the other countries, and to an even greater extent by a more accommodative monetary policy.

Even if we were to consider the macroeconomic dimension of the problem as extraneous to the scope of the present paper, in accordance with the approach that takes institutions into account as an important element in the coordination and regulation of market economies, we still must abandon the idea that we can be led to identify a ‘one best’ institutional framework corresponding to the most performing type of capitalism in the period under study. There is no unique type of performing capitalism, and it is therefore impossible to consider international comparison as a benchmarking operation and public policy as a problem of importing best institutional practices. Such practices neglect the obvious diversity of possible institutional coherences and the consequent varieties of capitalism. Indeed, a separate analysis of the different institutions characterizing labor-markets regulation and coordination, even if it permits a better understanding of the diversity of national labor markets regulations, leads to disappointing conclusions about the explanation of respective national performance in overcoming unemployment. First, the method of analysis is limited in its underlying principles: it consists of accumulating partial indicators (flexibility/rigidity, centralization or coordination/decentralization, active/passive employment policies), then attempting to find correlations between unemployment and employment rates. This process implies that if all the indicators point ‘in the right direction’, performance will be excellent. However, this is obviously not the case. For instance, we have shown that within the ‘success models’, the ‘resistance models’ are characterized by a high degree of coordination and centralization of labor-market institutions and that, as a consequence, they have the capacity to favor shared diagnoses and negotiated general agreements. A better hypothesis seems to be that overall efficiency can result from sometimes original overall coherences assembled between rules or legislation, which may *a priori* appear to be derived from opposing logics. For instance, a high level of unemployment benefits combined with active measures of individualized accompaniment of unemployed workers can promote a better reallocation of the work force in a more fluid labor market. Another example, centralized collective bargaining can make compatible, politically and socially acceptable overall moderation in wage claims, reduction of wage inequalities, reasonably good social protection, and the pursuit of greater flexibility in labor organization. The point is rather than studying partial indicators, taken one by one, then analyzing them from a linear and causal point of view, we must understand the possible deep coherences in social consensus built up around different possible types of labor-market regulations.

Finally, it is then possible to try to build a typology of capitalisms. Without being exhaustive, we can cross four different conceptions of the diversity of capitalism (Table below).

<table>
<tr><th></th><th>Hall & Soskice[1] (Varieties of Capitalism, 2001)</th><th>Esping-Andersen[2] (The Three Worlds of Welfare State,1990)</th><th>Amable[3] (The Diversity of Modern Capitalism, 2003)</th><th>OECD[4] (Employment Outlook, 2006)</th></tr>
<tr><td>Poland</td><td></td><td></td><td></td><td>Eastern Countries</td></tr>
<tr><td>United Kingdom</td><td rowspan="2">Liberal Market Economies[a]</td><td>Liberal Model[c]</td><td>Neo-Liberal Capitalism[g]</td><td>Anglo-Saxon Countries</td></tr>
<tr><td>Ireland</td><td></td><td></td><td rowspan="5">Northern Europe Countries</td></tr>
<tr><td>Denmark</td><td rowspan="8">Coordinated Market Economies[b]</td><td rowspan="5">Social-Democrat Model[d]</td><td rowspan="5">Social Democrat capitalism[h]</td></tr>
<tr><td>Norway</td></tr>
<tr><td>Sweden</td></tr>
<tr><td>Netherlands</td></tr>
<tr><td>Finland</td><td rowspan="6">Continental & southern Europe Countries</td></tr>
<tr><td>Germany</td><td rowspan="4">Corporatist – Conservative Model[e]</td><td rowspan="2">Continental European Capitalism[i]</td></tr>
<tr><td>France</td></tr>
<tr><td>Italy</td><td rowspan="3">Mediterranean Capitalism[j]</td></tr>
<tr><td>Spain</td><td></td></tr>
<tr><td>Portugal</td><td></td><td></td></tr>
</table>

As a first step, following the OECD (4), it is possible to establish a typology on the sole basis of a synthetic picture of heterogeneity in the policy settings and performance of labor markets, realized by the means of a principal-component analysis (cf. OECD, 2006, pp.221-224). It is, therefore, not yet a matter of analytically characterizing systemic coherences of “models of capitalisms”, but only an attempt to spot out “best practices”. In that ranking, good performances (both in terms of low level of unemployment and high level of employment) are shared by Anglo-Saxon and Northern European countries (including Ireland), whereas “bad pupils” are, probably not for the same reasons, continental and Southern European countries and Eastern European countries. Among “good labor market performance” countries, Anglo-Saxon Countries are characterized by low interventionism and supply-side interventions, whereas Northern European countries are characterized by strong interventionism and supply-side interventions. Continental and Southern European countries are characterized by strong interventionism and demand-side interventions. Finally, Eastern countries are characterized by low demand-side oriented interventionism.

The “varieties of capitalism” approach by Peter Hall and David Soskice (1) is a firm-centered political economy that regards companies as the crucial actors in capitalist economy (because they are the key agents of adjustment in the face of technological change or international competition). Therefore, each type of capitalism is characterized by the way in which the firms coordinate their decisions and their actions with those of the other agents, allowing the economy to reach satisfactory equilibriums. Two polar types of capitalisms can be then distinguished:

- In liberal market economies (a), firms coordinate their activities primarily via hierarchies and competitive market arrangements.
- In coordinated market economies (b), firms depend more heavily on non-market relationships to coordinate their endeavours with other actors and to construct their core competencies. The equilibriums on which firms coordinate in coordinated market economies are more often the result of strategic interaction among firms and other actors.

We understand that, from our point of view, it is impossible to distinguish, between these two types of economy that which could be set up in model. For instance, Denmark and Northern countries are obviously coordinated economies, as is Germany, but also France. Conversely, United Kingdom and United States are liberal economies.

It could then be interesting to go beyond this binary opposition and especially to refine our apprehension of “coordinated market economies”.

In that way, according to Esping-Andersen, each type of capitalism could favorably be characterized also by, firstly, its employment regime, defined both by the level of the employment rate and by the distribution of employment among society. Then, together with a system of social welfare and a type of domestic regime (i.e. the nature of social and familial structures), each so defined employment regime characterizes the mode of resources’ distribution among society. It can also be associated with a type of employment policy to definitely delimit systemic coherence of each “model” of capitalism (see Barbier and Gautié, 1998).

Thus, in liberal employment regimes (a), the main pursuing collective objective is purely economic. Thus, the quest for full employment (and for a correct allocation of employment by the way of market mechanisms) is a way to obtain the maximum amount of wealth (per capita), and the preference mode of access to resources is earning incomes (work first). On the contrary, social redistribution by the way of the welfare state is limited, which leaves a considerable place to the domestic redistribution (i.e. among households). The modes of resources redistribution can also be completed by a form or other of "positive discrimination" to authorize social inclusion of every category. Moreover this model is characterized by a low level of public expenditures for employment, and the great part that activation policies have gradually taken in the employment policy orientations (workfare policies).

In social-democratic economies (b), the main objectives are social-oriented. It's a matter of ensuring all citizens have access to a convenient level of resources. Thus, the employment level is high, but with the goal this time, not necessarily to improve global wealth, but to assure both incomes and autonomy to each member of society. But, above all, these economies are characterized by the place taken by social welfare, and its "beveridgian" logic[19]. The employment policy is important and tries to bind in a systematic way passive expenditures (like unemployment benefits) and activation measures.

In the continental-conservative model, employment rate is traditionally, relatively low. It reflects the relative exclusion from employment of some categories, and firstly wives (except France), young people, and senior. Economic distribution by the way of earned incomes is then reserved to the "male bread-winner". Social welfare (on the basis of a corporatist "bismarckian" regime[20]) and domestic redistribution are therefore important. Employment policies have became important under unemployment pressure, but passive expenditures remain dominant.

It is then possible to underline that, among these so-characterized three big types of capitalisms, at least two ways of institutional engineering could be promoted: liberal as well as a social-democratic model could be presented as possible inspirations to the others, especially to corporatist-continental countries, whose employment and welfare regimes have been particularly weakened by macroeconomic shocks, reduction of economic growth, and persistence of mass unemployment.

Precisely, even so reconsidered, our analysis remains too limited in its scope. Indeed, focusing on the sole labor market institutions comes down to neglect – and to take as exogenous – some variables which are obviously essential to explain unemployment levels: growth, productivity, type of insertion in the international division of labor, macroeconomic policy, etc… Here, a better hypothesis is that performances of labor markets depend on the ability to build a coherent economic and social development model, and so depend on the logical articulation between coherence of labor market institutional arrangement on the one hand, and other spheres of regulation on the other hand. It is especially important when one has to choose the way of reform, to remind ourselves that choices about labor market regulations are not independent from, and are not without implication on, other choices in other spheres.

For instance, according to Amable (2003), it is possible to underline that capitalisms not only differ by the type of their labor market regulation and by the type of their employment policies, but that institutional coherences also include the type of good

[19] The Beveridgian System tries to ensure a *universal* social protection (even for those which do not work). Social protection then is ensured by the State and is financed by the taxes
[20] The Bismarckian system rests on a "professional" Social Security. It is by the means of its work that one reaches social protection (system of contributions for the workers)

market competition, the type of social welfare, the type of educational system, the type of financial system, the type of specialization, and comparative advantage. For instance, according to this line, Amable then choose to distinguish, among continental "corporatist economies", "Mediterranean" capitalisms from the rest. But, again, the main point for us is not this. The very main point is in the fact that, thinking about the possible ways of reforming labor markets in order to definitely overcome unemployment in Europe and improve global efficiency of European economy, we have to consider that choices on that particular topic are also choices which will engage ourselves from the point of view of the type of social and economic development model we then define, and from the point of view of the type of society we choose to build in Europe.

These thoughts will lead us, in conclusion, to enlighten the political and cultural dimension of the whole problem.

B) Lessons: Reform paths and possible European scenarios

For all it is worth, the acknowledgment of the great diversity of national labor-market regulations and of their evolution over even the last fifteen years does not lead us to conclude by a diagnosis of an irreducible heterogeneity of labor-market institutional frameworks. Explicitly or implicitly, the main lessons that can be drawn from this article are the following:

- The overall performance of labor markets is fundamentally determined by economic growth. Therefore, the capacity of the European economy as a whole to overcome unemployment permanently will depend essentially on its ability to manage both a favourable macroeconomic *policy mix* that fosters strong and durable growth in the short run and the construction of structural reforms that define a performing model of economic growth and development in the long run.

- It is in this context, rather than directly by them, that employment policies and collective regulations exert a deep influence on labor markets. They indeed order both the adaptability of employment structures to massive economic changes and the ability to resist an increase in inequalities on labor markets, inequalities that could without doubt be destructive of our whole societies.

- In each European economy, one can observe a tendency to increase flexibility, both in the wage-formation mechanism and in employment management. The systematic 'activation' of employment policies is also currently observable, but the ways of organizing such an evolution remain widely differentiated.

- From this point of view and with the passing of time, it seems that countries opting for systematic deregulation of their labor markets, taking advantage of the collapse of wage owners' bargaining power provoked by massive unemployment, suffered high social costs without obtaining a greater capacity to create jobs as a counterpart. Consequently, in these countries, particularly in the United Kingdom and Spain, a reinforcement of collective rules by collective bargaining or even by government intervention can be observed. However, these countries (we especially think of the United Kingdom) remain characteristic of what can be called a 'social-liberal' model.

- Conversely, countries having at their disposal powerful collective bargaining mechanisms (particularly the Northern European countries and Germany) have agreed to decentralize its implementation. However, the ability to build up new compromises on that basis totally depends upon labor-market performance, which remains today very unequal within this group. Nevertheless, it seems that what can be called a 'social-democratic' model, typical of the Northern European countries (including the Netherlands), could be presented as a coherent alternative to the Anglo-Saxon 'social-liberal' model.

In Europe, it is evident that liberal policies of systematic deregulation of labor markets have not demonstrated their superiority in favouring both full employment and social cohesion. In any case, these policies are now called into question, at least in their extreme modes. Countries with important collective regulations have experienced widely different results for their part: schematically, good ones in the Northern, social-democratic countries and bad ones in the continental, corporatist countries. The problem for all is their ability to sustain the coherence of the preservation of collective regulations in the labor market and a high social protection with the continuation of deregulation in the other markets. This problem is clearly of institutional consistency and, beyond that, of institutional hierarchies.

Moreover, the European Union, which has assembled countries that predominantly fall within this second group, is also confronted with the problem of defining 'its' economic and social model: how to reconcile the deepening of the principles of a single European market with the elaboration of community norms and regulations applicable to *a priori* heterogeneous labor markets.

According to IRES[21] (2000), it seems that four scenarios remain possible today for Europe:

The first scenario is the continuation of current trends and the 'preservation' of a 'divided social Europe'. Following this scenario, we may observe the persistence of resistance to the transformation of national, labor-market institutions and welfare-state systems. The principle of subsidiarity may prevail and result in limiting European employment strategy to a procedural mechanism built on the sole definition of simple recommendations, inspired by 'best practices' and the necessity of coordination along broad economic policy guidelines. Such a scenario seems unstable, however, because it maintains the coexistence of heterogeneous social models and national labor markets. In such a context, non-cooperative behaviour is bound to arise (fiscal competition, competition on wage levels…), which would threaten political and social cohesion in the European Union. For this reason, such a scenario would obstruct even the homogenization of national models or the improvement of community solidarity.

[21] IRES is the "Institut de Recherches Economiques et Sociales" (Economic and Social Research Institute). The IRES has as a function to meet the needs expressed by the French trade-union organizations in the field of economic and social research.

Next, the second scenario postulates that the construction of a homogeneous European, social space is out of range. The solution to the problem could be found in a higher degree of solidarity between European countries, which would permit the preservation of national, institutional settlements. In this scenario, the role of community institutions would be greater, in order to edict more constraining guidelines, to develop community financing, and perhaps balancing budget resources to finance welfare systems.

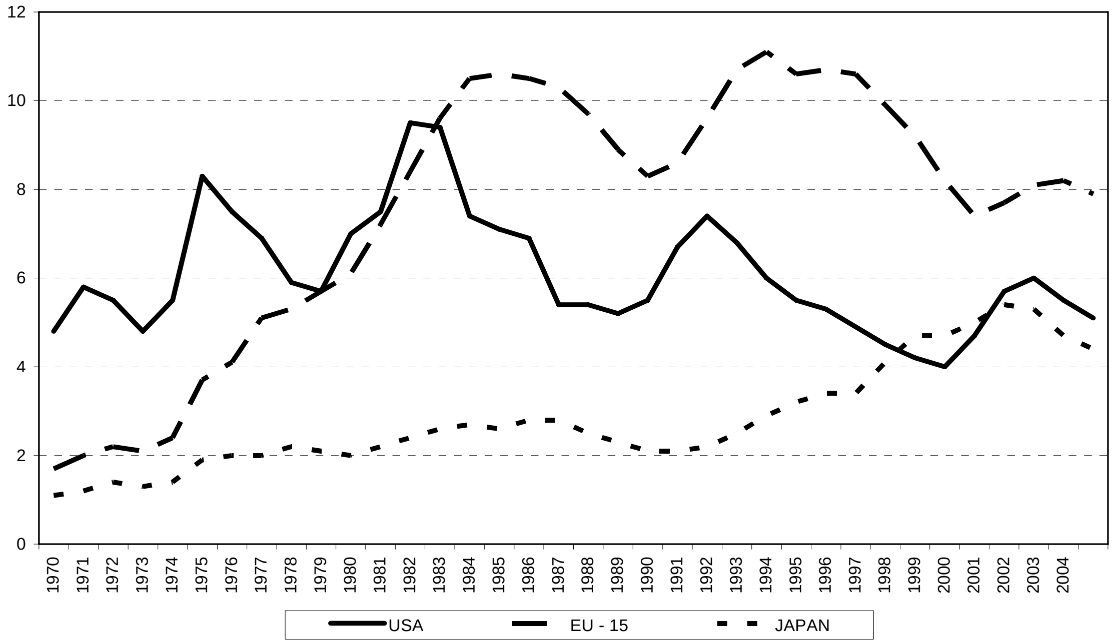
Conversely, the third and the fourth scenarios come with the ambition of setting up a truly homogeneous, European social and economic development model, but this homogenization could be attained by two quite different paths. First, it could be the result of the deepening of the principles of fiscal and social competition among European economies. This perspective would be built on complete market liberalization. Priority would be given to the respect of broad economic equilibria (budget stabilization and low inflation). It would converge on a free-competition model of labor markets in order to benefit from all the hoped-for, favourable effects of the single market. Such a scenario remains compatible with the preservation of a minimum security for individuals by means of the intervention of authorities in endowing individuals with the capital needed to preserve their empowerment, and especially their employability (human capital, social capital, financial capital…). In this scenario, the homogenization of the European model would be the construction of a particular type of 'flexicurity' inspired by English experiments. It obviously comes with a particular choice of society, conception of the individual, and conception of the social state.

In the end, a fourth scenario could be confronted with these particular choices and to this particular homogenization scheme. This last scenario could be built on the progressive widening of community rights, on a deep coordination of national employment and social policies, and on the improving of dialogue between employers, governments, and trade unions in collective bargaining on a European scale. In this last scenario, it is not the market and the competition between European countries that would be the main vectors of homogenization, but collective regulations, European solidarities, and political will. It would probably involve a deepening of political integration of the European Union. Nevertheless, such a scenario remains compatible with the extension of flexibility in labor markets and finally would appear in the development of an alternative type of 'flexicurity', inspired by the Northern, social-democratic, European countries. In that case, the possibility of improving flexibility of labor markets is thought as the result of compromises, collective bargaining, and political initiatives to secure professional paths and to ensure the 'capabilities' of individuals. There, too, the fourth scenario obviously would come within other particular choices of society, conception of the individual and conception of the social state.

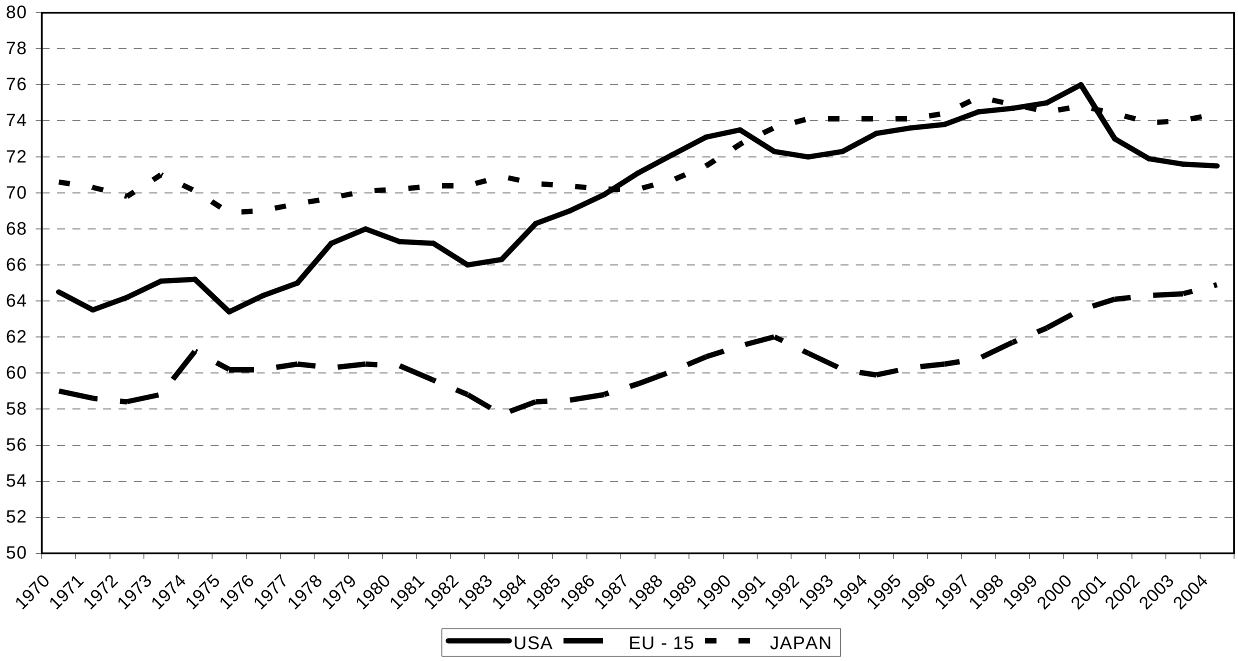
In any case, the proven existence of numerous scenarios shows that there is no single best and indisputable way to reform labor markets and to improve European performance to overcome unemployment and favour social inclusion. The problem now is the political determination, among the collective alternatives, of the type of society we want to build together in Europe.

Annex

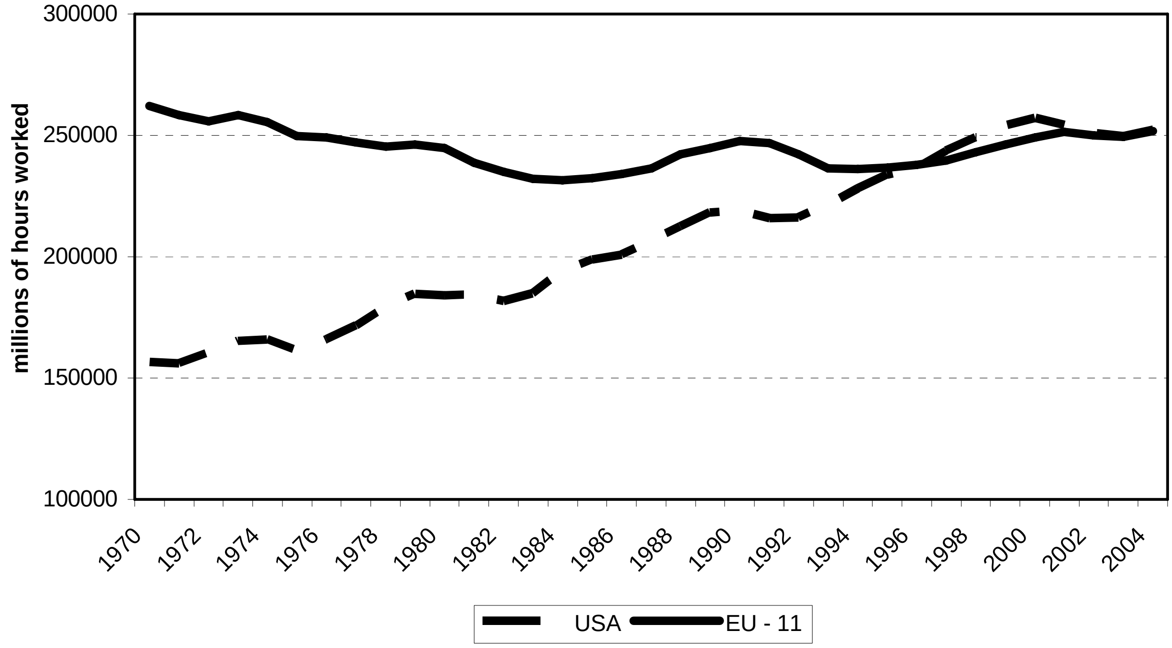
Graph 1: Unemployment Rate
(source: OECD)



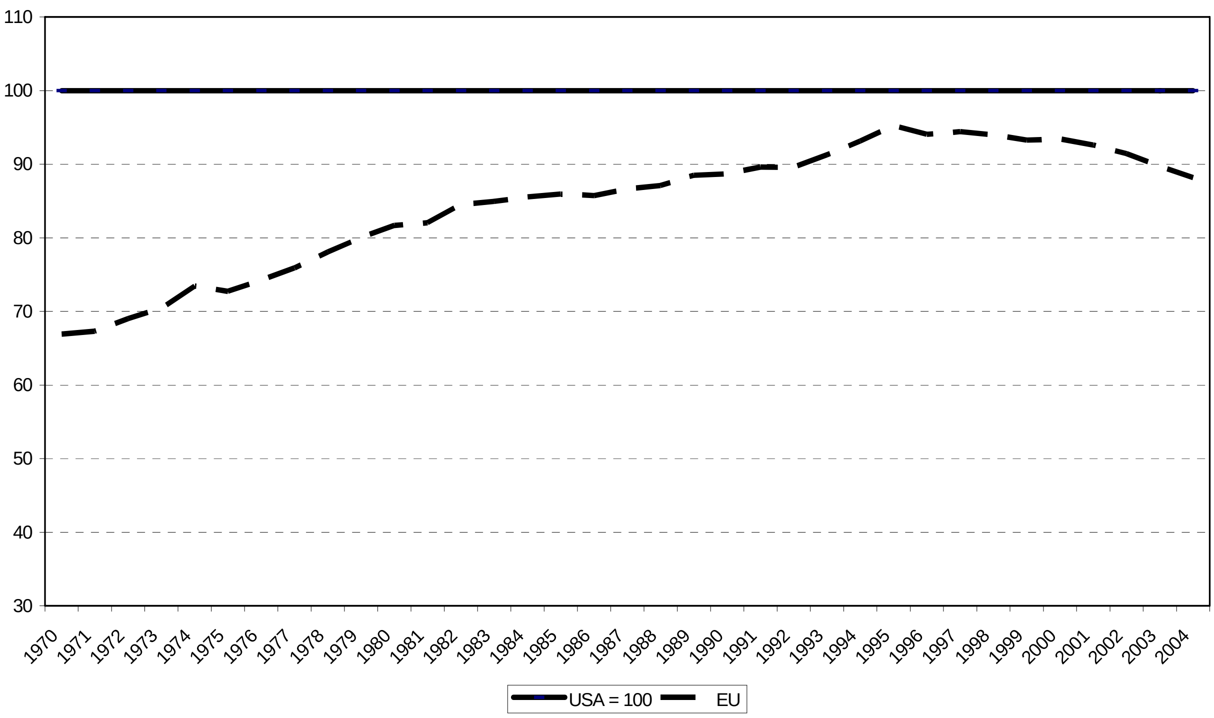
Graph 2: Employment Rate (15-64)
(source: OECD)



Graph 3: **Total Hours Worked**
(source: OECD)

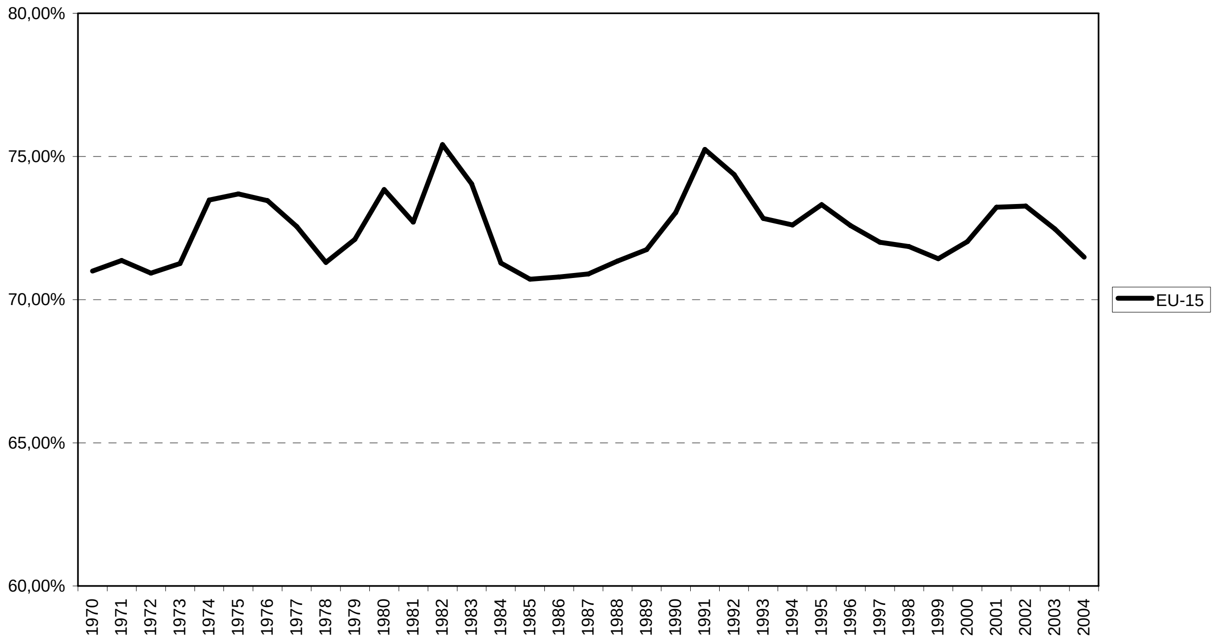


Graph 4: relative productivity (GDP per hours worked)
(source: OCDE)

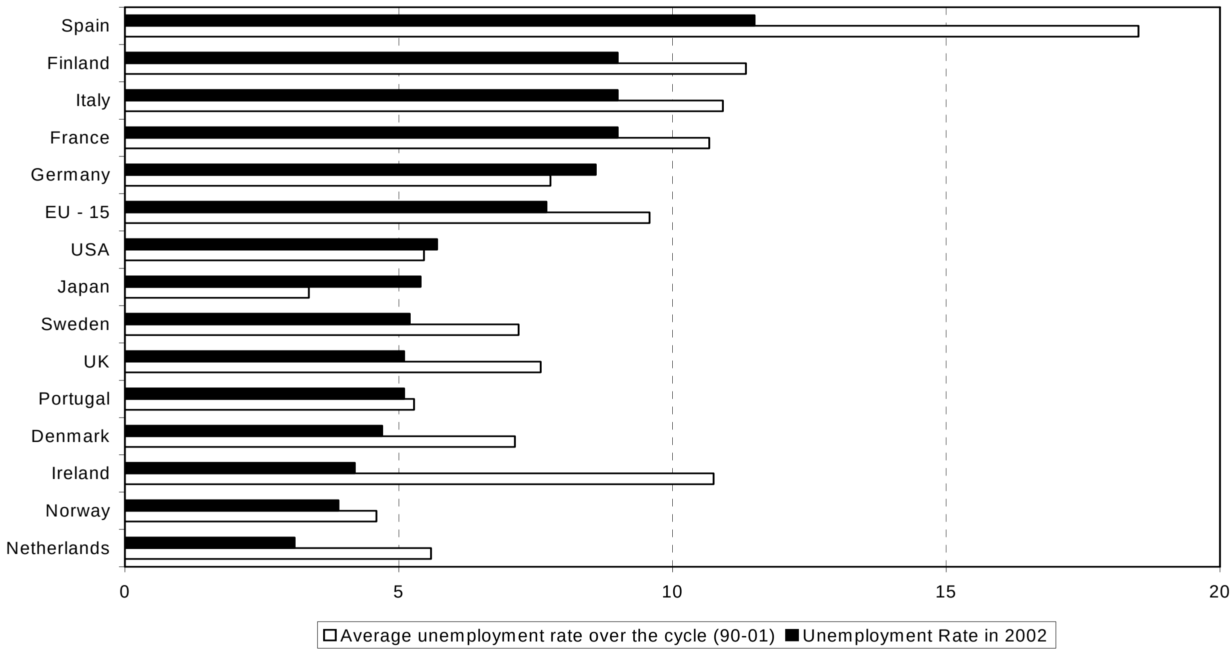


Graph. 5: GDP per capita
(source: OECD)

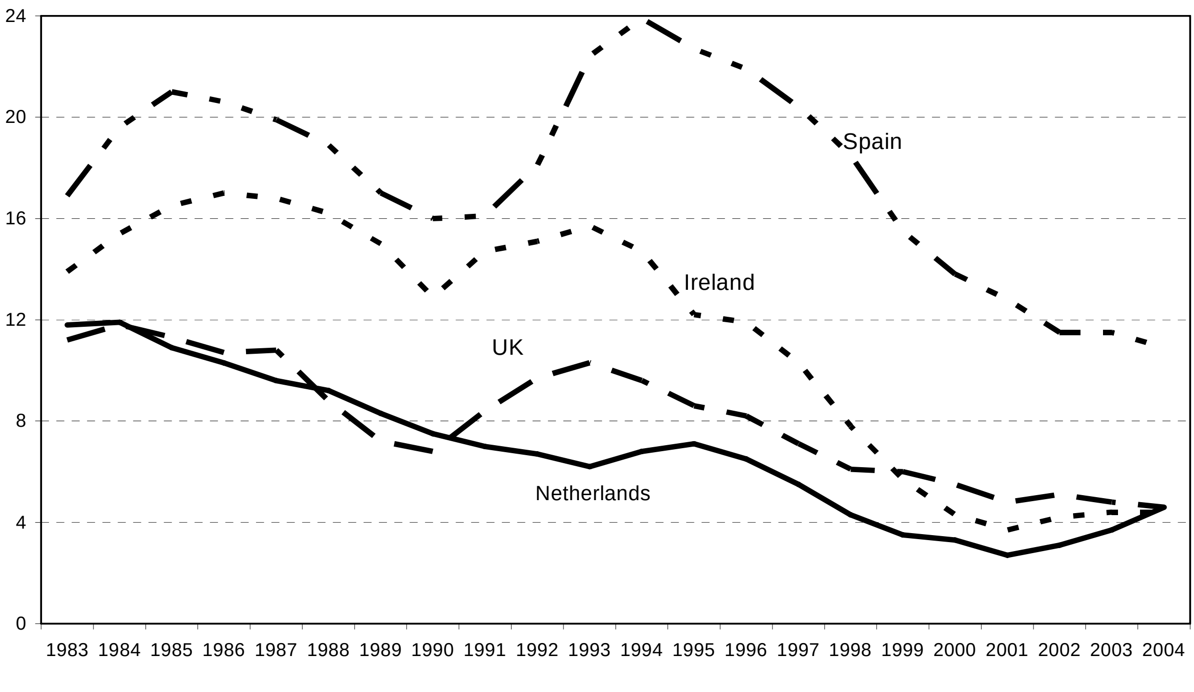
Graph 6: GDP per capita in Europe as a percentage of the american level
(Source: OECD)



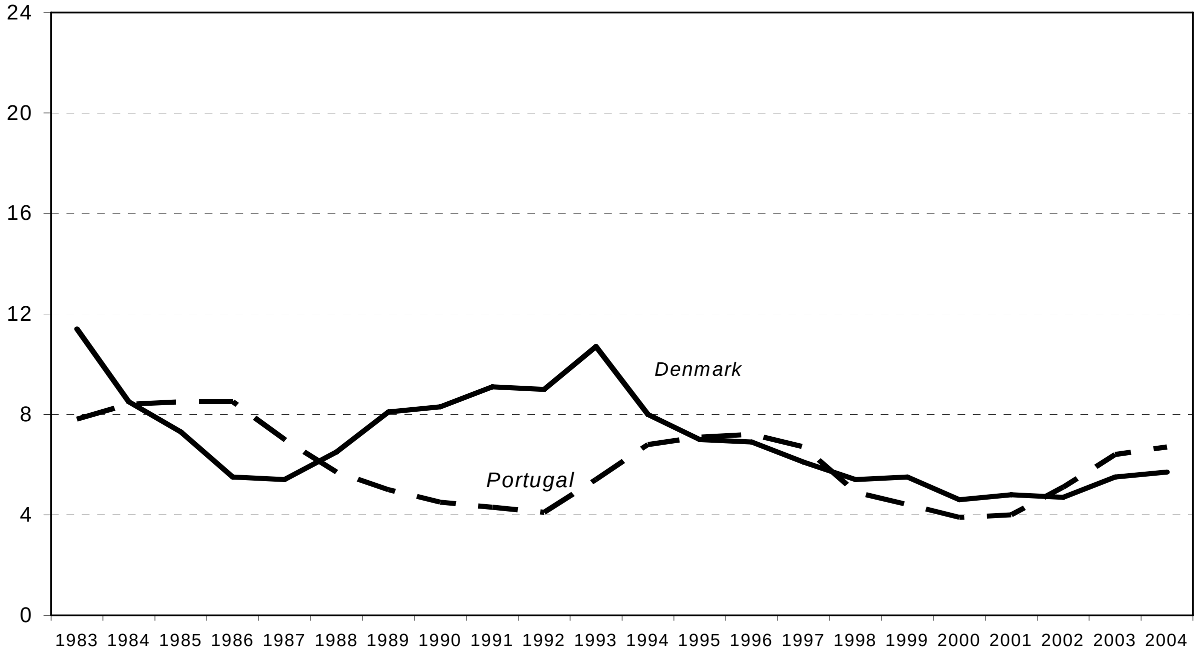
Graph. 7: Ranking of Countries in growing order of Unemployment
(source: OECD)



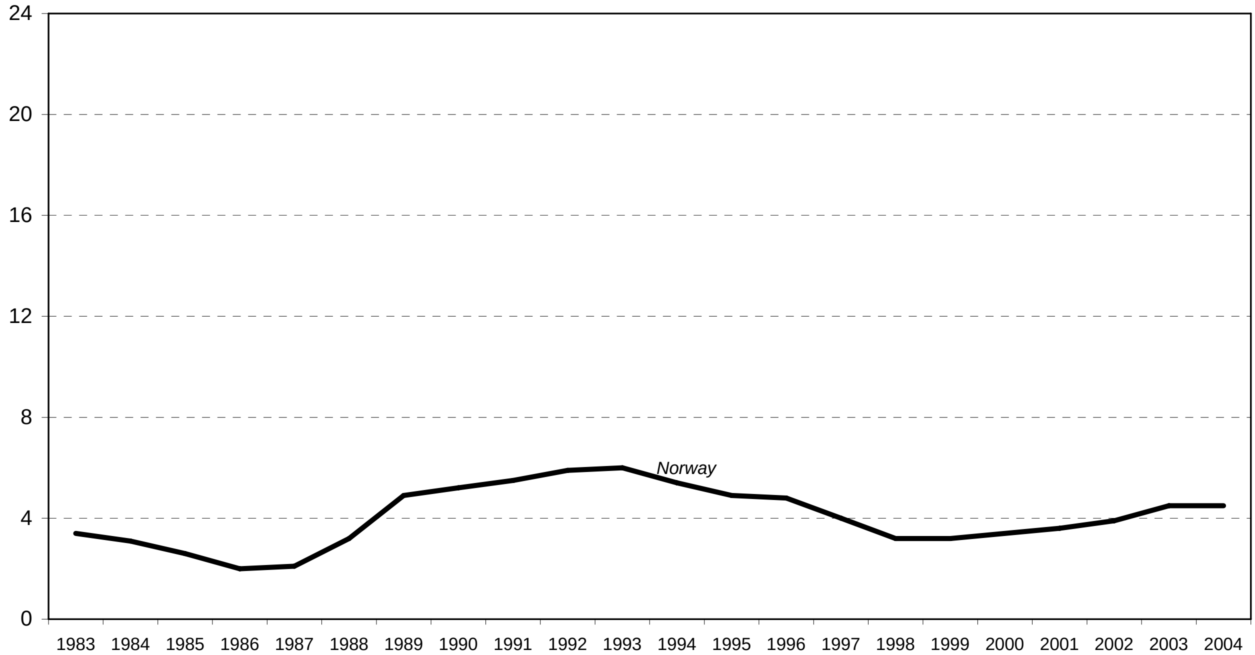
Graph 8.a: Continuous underlying downturn in Unemployment
(Source: OECD)



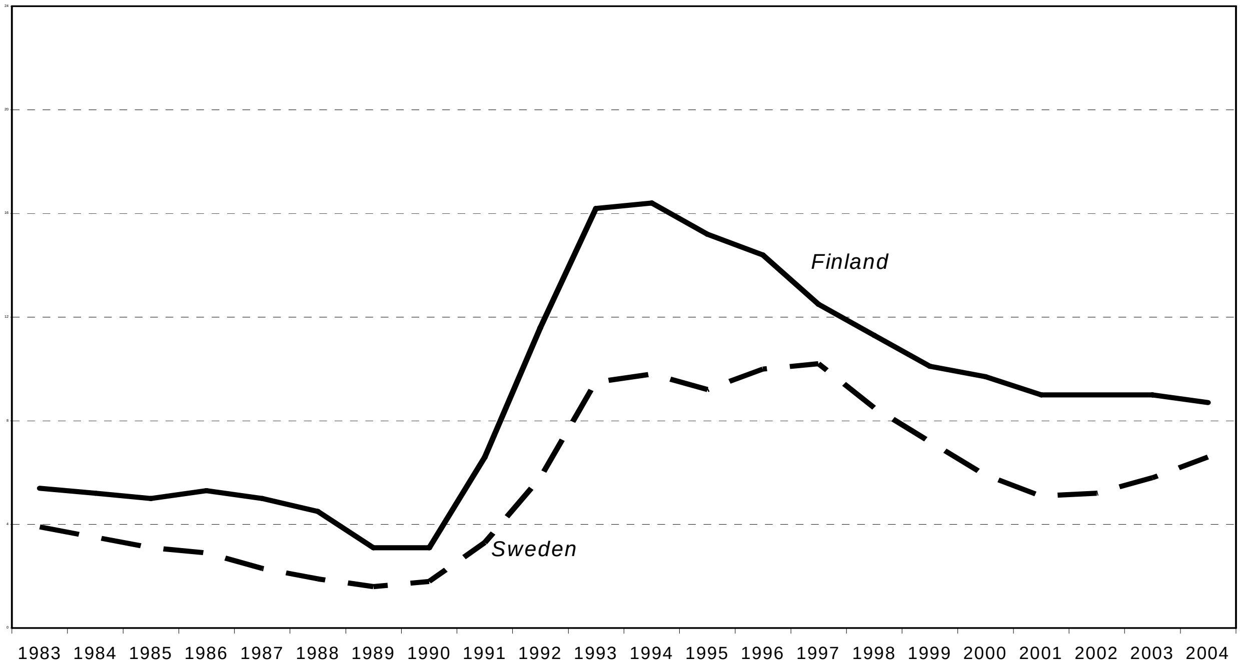
Graph 8.b: Slowly decreasing Unemployment
(Source: OECD)



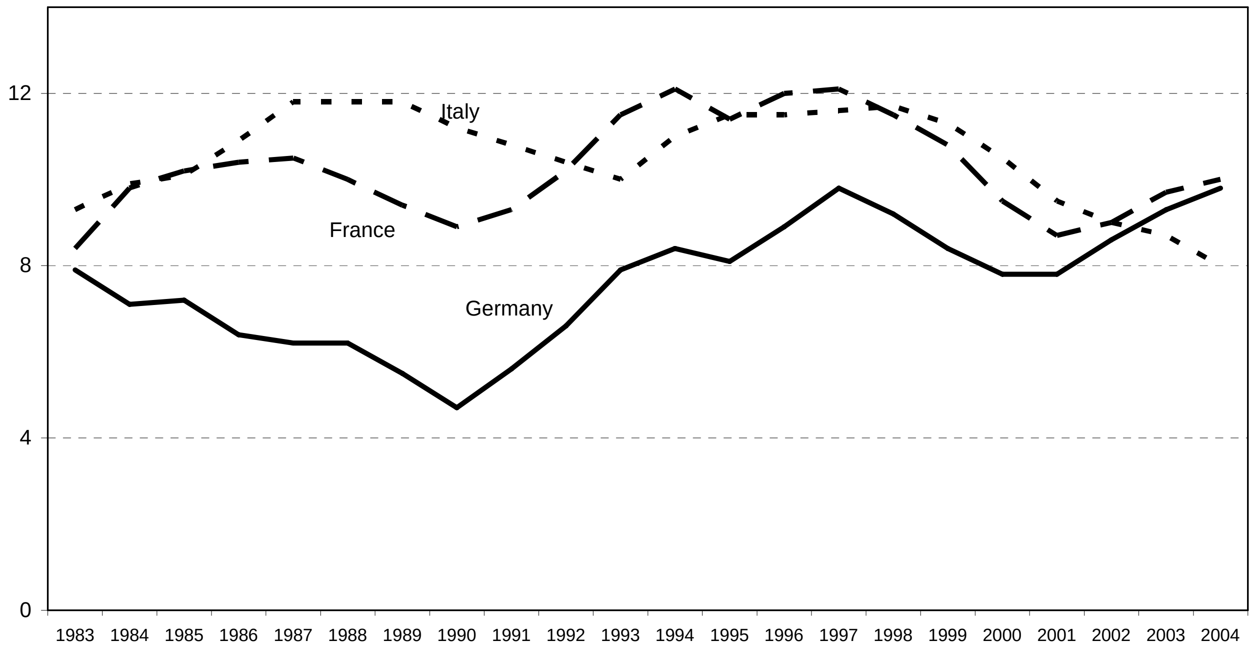
Graph 8.c Resistent low level of unemployment
(Source: OECD)



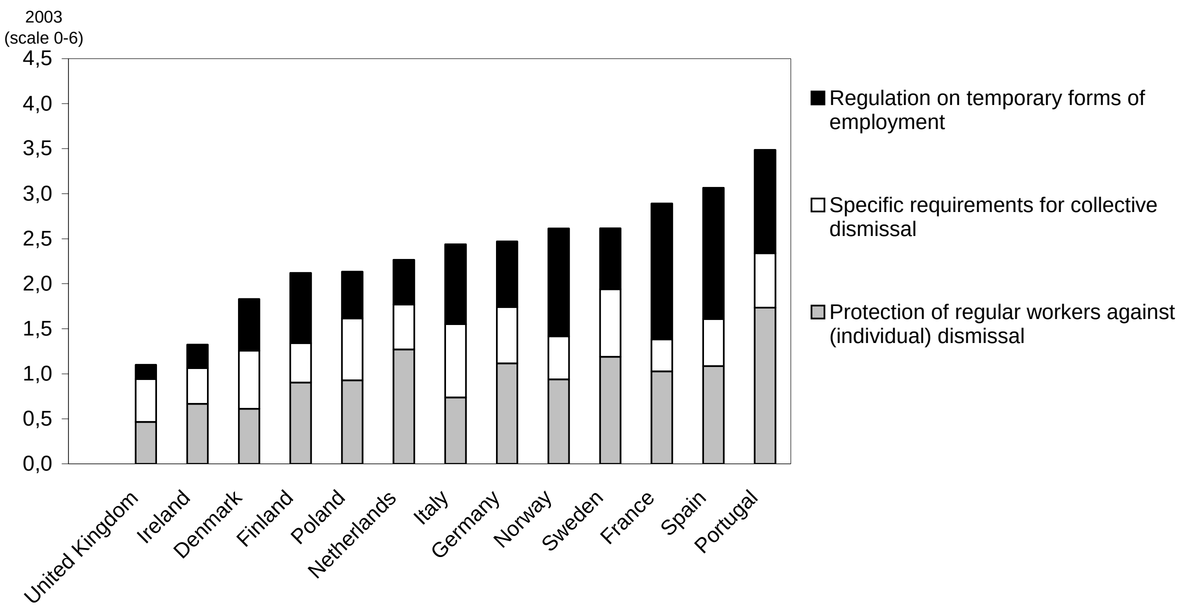
Graph 8.d: Upward break in unemployment trend
(*Source: OECD)*



Graph 8.e: Persistent mass unemployment
(source: OECD)



Graph 9: Overall summary Index of EPL strictness and its three main components, 2003
(Source: OECD)



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CHAPTER 4: Labor Market Dynamics of South and East Mediterranean Countries

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One of the most important problems of the South and East Mediterranean Countries (SEMC) is the high unemployment rate associated with an increasing, young labor force. The unemployment pressure, the existing labor-market structure increase, and in turn migratory pressure make job creation a top priority for the region.

Labor market dynamics of the region are marked with high unemployment rates, which are associated with an important informal sector. Increasing female participation rates are also adding to this unemployment pressure. In dealing with the unemployment problem, economic growth can be a key instrument. High output growth rates can create more jobs because, in the region, faster output growth is generally followed by lower unemployment rates.

In this study, we are going to analyse labor market dynamics of South and East Mediterranean Countries. In the first part, the labor market structure in the SEMC will be examined. The study will focus on the characteristics of population, labor force, participation rates, unemployment, and wages. The second part will study the relationship between growth, migration, and labor markets. The third part will conclude.

4.1: Labor Market Structure in the South and East Mediterranean Countries

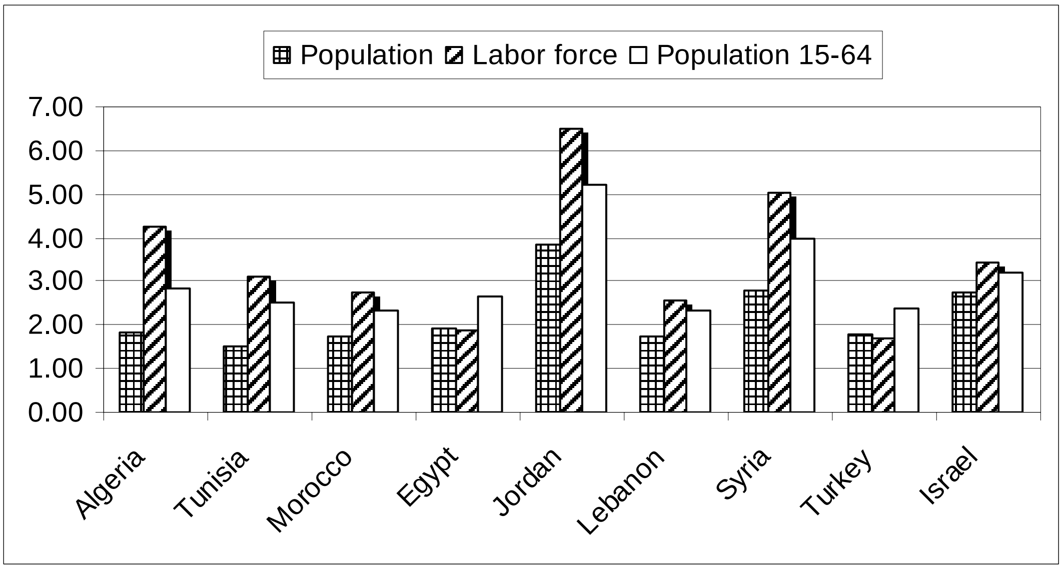
Before starting our analysis, it is important to mention that the part of the informal sector is very important in SEMC and it is difficult to fully capture the employment in the informal sector. In SEMC, the informal sector constitutes an essential component of the economy and contributes for a significant part to the national production. In Tunisia, in 2001, the production of the informal sector was estimated around 37% of the national value added. In Algeria, in 2002, the informal employment accounted for 36,5% of total non-agriculture employment and 39% of total urban employment[22].In Morocco, in 2003, the informal sector included around 40% of the non-agriculture employment and 20% of the total employment. Also, in Turkey, the informal sector is very important. The ratio of unregistered employment in non-agricultural sector was around 26% in 1995. This

[22] It is important to note that the increase in the informal sector in Algeria (90s) coincides with the decrease in the part of public sector.

ratio had an increasing trend and rose to 34% in 2004. Around 76% of these unregistered workers are employed in the informal sector (FEMISE). In this study, as we are working with official statistics, it is possible that the unemployment rate for the region is overestimated. However, this possible overestimation of unemployment would not have an impact on our analysis of migration pressures. For the employees of the informal sector, the motivations to migrate will remain.

The labor force consists of people of working age who are *participating workers*. Participating workers are those who are employed or actively searching for employment. The population trends are essential to understand the structure of labor supply. The first remarkable finding for the SEMC is the pressure of young workers on the rapid, labor-force growth. The rapid growth of the working age population in the region is due to the high population growth rates between the 1950's and the 1980's. On the other hand, in all of the countries in the region, with the exception of Turkey and Egypt, in spite of this pressure of young workers, the increase in labor force has been faster than the increase in working age population over the last 15 years (see Figure 1). This means that many of the working age population who were discouraged workers are increasingly becoming participating workers (a phenomenon that can partly be explained by the rising female labor participation rates).

Figure 1. Population, Labor Force and Working Age Population 1990-2004



Average annual growth rates
Source: World Bank – World Development Indicators (WDI)

The *Labor force participation rate* is the ratio between the labor force and the overall size of the national population of the same age range. This rate indicates the impact of demographic pressures on the labor markets. Labor-market participation is affected by many factors, including:

- Education level, which increases participation rates;
- Duration of schooling, which lowers participation rates for the young labor force;

- Inclusion of women to the labor markets, which increases participation rates; and
- Availability of job opportunities, which increases participation rates (while the lack of job opportunities decreases participation rates).

Table 1 shows the participation rates of the total population for the chosen SEMC. In the Maghreb countries, labor force participation rates have gradually increased over the last 24 years, especially in Algeria. This trend can be explained in particular by the rise of the education level, the rise of celibacy among women and by the increase of the jobs (which require less qualification) employing female labor (textile etc.). For example, female participation rates increased during the 1990s by 6% for Algeria, 4% for Tunisia and around 2% for Morocco.

However, the trend is different in Mashrek countries. For Jordan and Syria, there is a progressive increase in participation rates, as opposed to a more stable trend for Lebanon and Egypt. In Syria, from 1983 to 2002, female participation rates have doubled, increasing from 12% to 24% of the working age population[23]. On the other hand, in Egypt, despite a 4% increase in the female participation rates during the 1990's, the participation rate of the labor force has roughly remained stable or decreased.

From the 1980's to the early 2000's, the participation rate of the labor force has increased around 4% for Israel. On the other hand, Turkey, which enjoyed the highest labor force participation rate out of the SEMC countries during the 1980's, experienced a 13% decrease. Among others, we have two explanations for these decreases in Turkey: the early retirement system and the increase in average education duration. Finally, for the SEMC, with rising labor force participation rates since 1980, the growth of labor supply and the increase in the absolute number of new labor market entrants have augmented over time.

Table 1. Participation Rates, 1980-2004

	Algeria	Tunisia	Morocco	Egypt	Jordan	Lebanon	Syria	Turkey	Israel
1980	51,47	52,85	54,33	46,82	46,27	59,14	54,21	69,64	57,97
1985	50,59	51,76	54,42	51,23	47,51	58,20	53,99	63,29	58,53
1990	52,53	51,50	54,87	52,89	47,55	57,26	57,79	61,51	59,33
1995	55,39	52,59	55,52	49,51	54,44	59,17	61,61	57,68	61,73
2000	60,59	54,03	58,42	49,18	54,04	60,02	63,98	53,23	62,47
2004	63,81	56,12	57,90	48,88	55,71	60,21	65,86	56,13	62,27
Average	**55,73**	**53,14**	**55,91**	**49,75**	**50,92**	**59,00**	**59,57**	**60,25**	**60,38**

Source: LABORSTA, International Labor Organization

[23] However, compared to the demographic pressures, it is discussed that the overall impact of the rise in female participation rates remained small. (FEMISE 2006)

Table 2 shows the labor force participation of the SEMC by type of economic activity. For Algeria, Morocco, Egypt, and Turkey, agriculture occupies the biggest fraction of the labor force. However, compared to the main European countries, manufacturing occupies a small part of the labor force of the region, except for Israel and Turkey. The share of manufacturing in the labor-force participation is 17% for France and 22% for Germany and Italy. Insurance, finance, and real estate occupies a very small part of the region's labor force, except for Israel. This ratio is 10% for Italy, 12% for France and Germany, 15% for the United Kingdom, and 16% for the Netherlands. This can be a good indicator because it may demonstrate the lack of solid financial markets in the region, which in turn may have implications on the investment environment, and, as a result, on the new job creation capability of SEMC.

Table 2. Labor Force Participation by Type of Economic Activity, Selected Activities, 2003 (%)

	Algeria	Morocco	Egypt	Jordan	Lebanon	Turkey	Israel
Agriculture and fishing	21,1	43,9	29,9	3,9	6,7	33,9	1,9
Manufacturing	9,2	12,4	10,9	12,6	14,1	17,3	16,2
Construction	11,9	6,8	7,4	6,3	9,4	4,6	5,6
Trade, Restaurants and Hotels	14,7	14,6	13,5	20,4	35,2***	19,2	17,5
Transport	6,0	3,6	6,3	10,2	6,9	4,8	6,4
Insurance, Finance and Real Estate	2,0	1,3	3,0	5,7	-	3,5	16,3
Public Administration and Defence	16,0	5,1	11,2	32,7**	8,4	5,6	5,2
Education	9,4	11,29*	10,9		10,0	4,1	12,7
Health and Social Work	3,7	-	3,0		4,0	2,5	10,7

Source:LABORSTA for Algeria, Morocco, Egypt, Turkey and Israel, Femise Country profiles for Lebanon and Jordan 2003 for Algeria and 2001 for Lebanon

* Education, Health and Social Work reported together

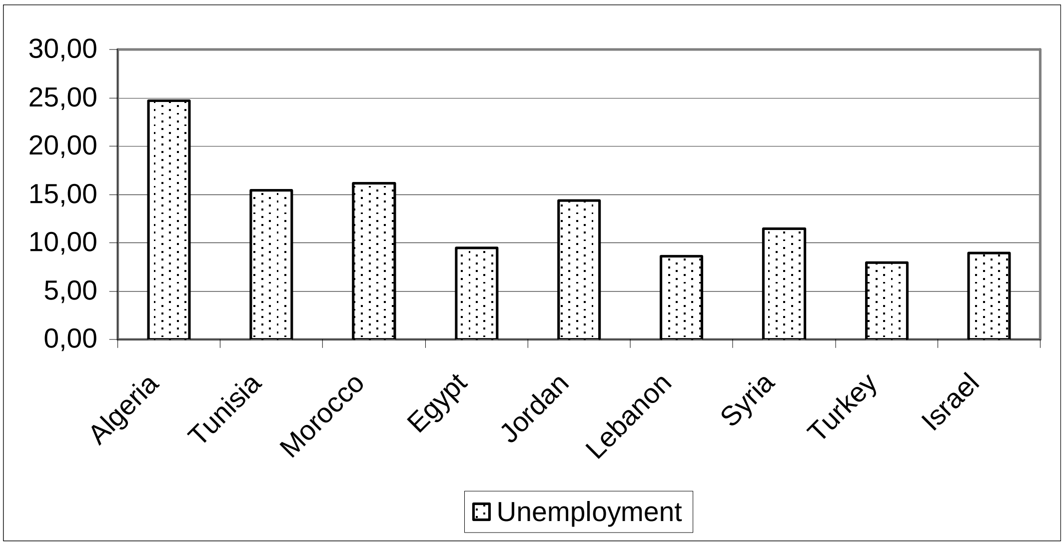
** Reported as public administration and social services in the country profile document

***Reported as services in the country profile document

The share of public administration and defence in the labor-force participation is greater than that of manufacturing in Algeria, Egypt, and Jordan. This percentage was 7% in Germany and 6,5% in United Kingdom in 2004 (superior to Morocco, Turkey, and Israel). Except for Israel, health and social work occupies less than 5% for all countries of the region. This percentage was around 10% for Germany and 11% in United Kingdom in 2004. Another important indicator is the percentage of education in labor force participation. The part of education in the labor force participation was 4,1% in Turkey, 9,4% in Algeria, around 10% in Egypt and Lebanon, and about 13% in Israel.

If the labor supply exceeds the employment level, the unemployment rate rises; and over the past decade the growth in the labor force has exceeded employment growth in most countries of the region. Figure 2 shows the average unemployment rates of the SEMC for the 1990-2002 periods. The region entered the 1990s with relatively high unemployment rates that continued to increase in most countries. The unemployment rate for the region ranges from 8% in Turkey to over 25% in Algeria. The average unemployment rate for all of the countries of the region rose from 12.6% in 1990 to 14.12% in 2000. On one hand, this situation is a result of insufficient growth in the region and, on the other hand, a result of rapid population growth and growing labor participation rates, specifically for women. The average unemployment rate which is about 13% for SEMC was around 6.5% in OECD countries for the 1999-2002 periods. Another evolution contributing to the increase in unemployment rate is the decreasing part of the public sector in most of the countries of the region. Public sector, especially the state owned enterprises occupied an important place in job creation of the region. Privatization of certain public companies and the weak performance of the private sector in creating jobs had an increasing impact on unemployment especially for the new entrants since the 1990's.

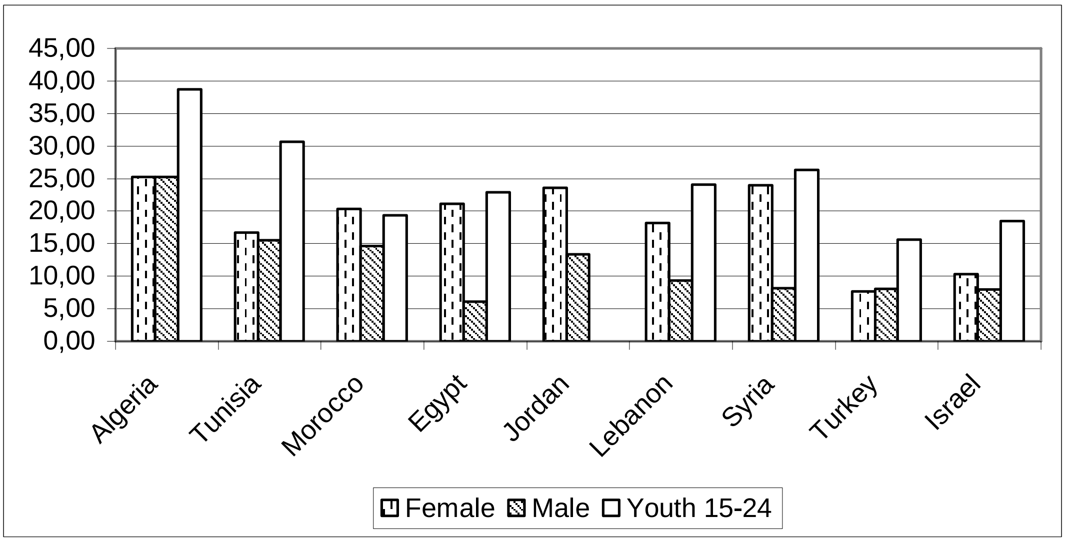
Figure 2. Average unemployment Rates, 1990-2002



Source: World Bank, WDI

Jordan has faced the highest growths in labor force and working-age population of the region (see Figure 1), but the unemployment rate decreased over the decade. This trend can be explained partly by the migration of skilled workers to countries of the Gulf Cooperation Council. Algeria has the highest unemployment rate of the region, which was about 24.7% between 1990 and 2002. This was partly due to the increase in labor participation rates. Although Turkey had the lowest average unemployment rate for the 1990-2002 period, its overall unemployment rate was about 10%, and the non-agriculture unemployment rate was about 15%, a result of the financial crisis of 2000-2001. Tunisia and Egypt experienced small declines in unemployment rates in the 1990's, but the trend changed for Egypt at the beginning of 2000's with rising unemployment rates. In Syria, unemployment rate was around 4% in 1983. It worsened over time and reached nearly 12% in 2002.

Figure 3. Average Unemployment Rates: Female, Male, Youth (15-24) 1990-2002



Source: World Bank, WDI

Figure 3 shows the average unemployment rates of male, female, and youth populations for the SEMC. The unemployment rate among the youth population lies between 15% and 38%. For all of the countries of the region for which data is available, the unemployment rate of the youth population is the highest, which makes job creation an important challenge for the region. In order to absorb this growing young labor force, the economies of the region need economic growth accompanied by an increasing labor demand. The unemployment rate of the youth population has also a migration dimension. The unemployed young labor force may attempt to emigrate in order to try their chance in the industrialized countries of the North.

In Algeria, one of the remarkable characteristics of unemployment is that it concerns directly the younger population and the first time job seekers. In 2003, about 63% of the unemployed population were first time job seekers and nearly 73% were less than thirty years old. In Morocco, the unemployment rate is very high for the young population aged 25-35 years old, most of whom are first time job seekers like in Algeria. However, in Lebanon, most of the unemployed workers are the ones who have lost their jobs (around 64%)[24]. (FEMISE)

Another important labor market variable is the wage levels. In Tunisia, minimum wages increased, in real terms, at a moderate average rate of about 1,5% over the period 1994-2000. In 2001, the wages in the public sector were on average 18% higher than those of the private sector. The women were disfavoured compared to men. They were receiving wages 14% lower than that of the men. In Algeria, one of the most important characteristics of the economy is the dominance of the hydrocarbon sector. The

[24] In 1997, around 60% of unemployed workers were first time job seekers in Lebanon.

hydrocarbon sector offers wages higher than the other sectors creating distortions in the intersector allocation of the labor force. In Morocco, in the informal sector, family relations are very predominant. The wages are determined by the price of the work done, rather than the number of hours worked. However, in the rural sector, the wages are determined by the hours worked. In the secondary sector, the determination of wages is very heterogeneous, which is due to the lack of collective agreements and to the existing heterogeneity between firms.

The difference between male and female wages is also observed throughout the SEMC. In Lebanon, the wages of women are around 20% less than that of men. In Jordan, the wage difference between men and women depends on the occupations and the sectors. The gap is less important in the public sector than the private sector. The sectoral analysis shows that the wage gap is in favour of females in services. However, in occupations like machine operators, craft, and professional occupations, the wage gap is more in favour of men. In Syria, there is not a big difference between the wages in the public sector and the private sector. In both sectors, the wages are very low and, in general, workers hold multiple jobs. However, the public sector still offers advantages, such as social security and job security. In Egypt, in spite of the stagnation of real wages in the first half of the 1990's, in the second half of the 1990's, real wages increased at an average annual rate of 3,9% in state-owned enterprises, but only 0,8% in the formal private sector.

In Turkey, from 1989 to 1993, there were increases in real wages. This increase was supported by the public sector, which also encouraged the wage increase in the private sector. The 1994 and 2001 economic crises depressed the real wages; however, wages recovered during the economic growth following the crises. Then, during the 1996-2001 period, the wage differential grew between the public and the private sectors. In Israel, real wages increased in 2004 after the downward trend in 2002 and 2003. Financial services, business services, and the manufacturing sector had the highest real wage increases. However, they are still below their averages of 1995-2001. In Israel, real wages in the public sector rose more than real wages in the private sector. (FEMISE)

4.2: Labor Markets, Growth, and Migration

In the SEMCs, reforming the labor market is very difficult to carry out. Because of high unemployment rates and waves of dismissals after privatization, introducing allowances for unemployed workers became very costly. Within the Euro-Mediterranean partnership, the European Union proposed the training of the labor force. However, these countries have an important unemployment of their qualified workforce. Moreover, the application of European standards causes a deskilling of workers and a degradation of their diplomas and local know-how which does not concern only traditional professions, but also their knowledge and their experience accumulated during the self-centred development period. Finally, weak integration among the economies of the South accentuates the centre-periphery effect. However, with recent initiatives aiming at decreasing the obstacles to trade between the SEMC (Agadir Agreement, Arab Free Trade Zone), the countries of the region can profit more from the existing complementarities between them. In the SEMC, the problems caused by the low performance of economic and social reforms are added to the difficulties related to insufficient, sectoral distribution of economic activities and the asymmetrical character of the Euro-Mediterranean partnership (Dupuch, Mouhoud and Talahite, 2004).

One of the most important indicators of trends in labor demand is the output growth. In the region, faster output growth is generally accompanied by lower unemployment rates. Table 4 gives the GDP per capita and the unemployment growth rates for the region. Since the 1990's, weak output growth coupled with fast labor force growth caused high unemployment rates.

In order to create new job opportunities, improving the output growth should be one of the main objectives of the region so as to accommodate the increasing young labor force. Governments of the region should contribute to the creation of productive job opportunities through economic growth. They should set up reforms that include improving the education system and the business environment.

Table 4. GDP/capita Growth and the Unemployment Rate

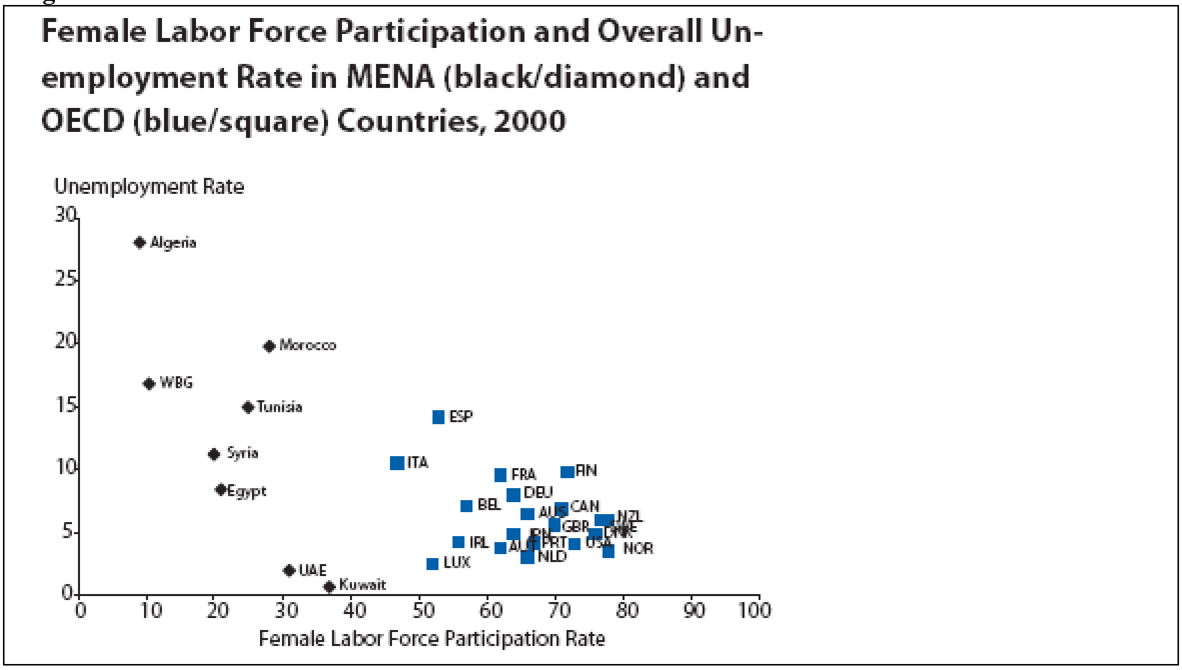
	Algeria		Tunisia		Morocco		Egypt		Jordan		Turkey		Israel	
	Unemp Rate	GDP/capita Growth % (Cst $)	Unemp Rate	GDP/capita Growth % (Cst $)	Unemp Rate	GDP/capita Growth % (Cst $)	Unemp Rate	GDP/capita Growth % (Cst $)	Unemp Rate	GDP/capita Growth % (Cst $)	Unemp Rate	GDP/capita Growth % (Cst $)	Unemp Rate	GDP/capita Growth % (Cst $)
1997	28.00	-0.44	15.70	4.00	16.90	-3.34	8.40	3.53	14.40	0.20	6.80	5.61	7.70	1.06
1998	28.00	3.62	NA	3.46	19.10	6.45	8.20	4.26	NA	-0.09	6.90	1.28	8.50	1.35
1999	29.20	1.77	15.80	4.68	13.90	-1.22	8.10	4.10	15.60	0.28	7.70	-6.34	8.90	-0.24
2000	29.50	0.95	15.60	3.49	13.60	-0.20	9.00	3.41	13.70	1.11	6.50	5.56	8.80	4.86
2001	27.30	1.10	15.00	3.67	12.50	5.08	9.40	1.54	16.00	2.25	8.40	-8.99	9.30	-2.58
2002	25.90	2.55	14.90	0.55	11.60	2.01	10.20	1.24	NA	2.84	10.40	6.24	10.30	-3.11
2003	23.70	5.18	14.30	5.01	11.90	4.32	11.00	1.14	15.50	1.40	10.50	4.17	10.70	-0.13

Source: LABORSTA

However, it is essential to know the determinants of GDP growth. If GDP growth is constrained by supply, technological developments can have a positive impact on growth. It would increase the profitability of production and this, in turn, would have a positive impact on employment and investment. On the other hand, if GDP growth is constrained by demand, technological progress would destroy jobs because the same amount of production can be assured by less labor. Another possibility would be a decrease in wages to promote more employment. In the case of output growth constrained by supply, wages would not decrease necessarily after a technological improvement. As we have discussed before, job creation is a top priority for the region, but the effect of promoting labor-intensive production in order to promote job creation is ambiguous (Gardner, 2003[25]).

[25] *Creating Employment in the Middle East and North Africa*, Edward Gardner, IMF, 2003

Figure 4



Source: World Bank, *Jobs, Growth and Governance in the Middle East and North Africa*, p. 32.

Apparently, there also exists a gender dimension in labor markets. Unemployment rates as a whole for all countries are 50% higher for women, (18%) for women (12%) for men. In the existing literature, this is mainly explained by the increasing participation rate of the female population in the economy and the decrease in hiring in the government, which treats women equally to men. (See Figure 3) However, in Figure 4, we see a negative relationship between unemployment rates and female participation rates. One of the most important needs of the region is the human capital stock and a non-participation of female labor force represents an underutilization of potential human capital. As women in the region are better educated, the cost of their non-participation becomes very high. A greater participation of women in the labor force would increase the family level of income and make labor markets more flexible. It is becoming more and more important that the governments of the region should encourage, in the private sector, the inclusion of female labor. (World Bank 2003)

Migratory movements can be explained by push-pull factors. Push factors are the factors in the country of origin of migrants, which cause them to leave their country. Main economic push factors can be summarized as unemployment and weak social security system. Pull factors are the factors in the destination countries, which attract migrants. These factors include mainly higher wages and better working conditions. The high level of labor supply accompanied with high unemployment rates and an important informal sector encourages the emigration pressures in the region.

We can consider two types of migration for the South and East Mediterranean countries: migration within the MENA region and migration outside the MENA region. The Mashrek countries of Egypt, Jordan, Lebanon, and Syria have a migratory history among themselves. For Egypt, most of the migration flows is a temporary migration to the

Arabic Peninsula, especially to Saudi Arabia, Libya, Kuwait, and the United Arab Emirates. For non-qualified Syrian migrants, Lebanon is the major destination. These workers are mainly recruited in construction, agriculture, hotels, and restaurants. However, qualified Syrian workers migrate mostly to the Gulf countries. Like most of the countries of the region, migrant remittances are one of the main sources of foreign currency in Syria. Lebanon is at the same time a migrant receiving and sending country. As mentioned above, most of the migrants coming to Lebanon are non-qualified workers. However, during the 15 years of war, the emigration from Lebanon was massive. The main destinations were particularly to the United States, Europe, and the Gulf countries. Approximately 600.000 Lebanese emigrated between 1975 and 2001, with 45% of them migrating after 1990 (following the war) (FEMISE).

Western Europe is a key destination of migration from the Maghreb countries. Among the European countries, colonial ties and linguistic communities made France the most important recipient, before Belgium. However, in the past 20 years, the population from the Maghreb in traditional recipient countries such as France and Belgium has decreased both in relative and absolute terms and has increased in Spain and Italy. The main reason for this may be seen as the increasing unemployment rate and tightening of migration policies in the traditional receiving countries after the end of the industrial boom of the 1960's. Morocco had a policy of maximizing emigration in order to deal with unemployment problems and to receive remittances. Tunisia and Algeria have also followed a similar policy.

The migration of Turkish workers started in the early 1960s, going mainly to Western Europe and especially to the Federal Republic of Germany. After cessation of labor migration to Europe in 1974, the flow of Turkish workers was directed toward the Arabic Peninsula, and, after 1990s, toward the states of the ex-USSR. Labor migration of Turkish workers to the Arabic Peninsula and to the ex-USSR states is mostly temporary migration.

Israel constitutes an exception. It can be considered as a nation of immigrants. Jews have the right to immigrate to Israel, and they receive automatic and immediate citizenship. After 1967, Israel recruited non-citizen Palestinian workers from the West Bank and the Gaza Strip. These were day-laborers, entering the country by day and leaving at night. However, since the 2000's, Israel has been receiving emigrants from Romania (construction), Thailand (agriculture), and the Philippines (nursing and domestic services). (Baldwin-Edwards 2005)

4.3: Conclusion

This study analyzed the labor market dynamics of the SEMC. It shows that high unemployment rates are one of the most important problems of the region. Young increasing labor force puts pressure on the labor markets and makes job creation a priority. Another implication of this phenomenon is the migratory pressures. However, as mentioned above, the informal sector is very important in these countries. This can cause an overestimation of unemployment rates, but not an overestimation of migratory pressures. For the employees of the informal sector, motivations to migrate remain. This is also the case for the qualified young labor force. As long as the labor markets are insufficient to create jobs suitable for the qualified young workers, they will prefer to migrate to more industrialized countries (to the European countries for the case of most SEMC).

For the countries of the region, it is important to create more job opportunities in a more stable and solid labor market environment. One of the key instruments of this challenge can be high economic growth. In this context, the Euro-Mediterranean partnership can play a key role. More integrated commercial and financial markets should be complemented with more integrated labor markets. The countries from the North should encourage the labor market reforms, job creation and economic growth.

Compared to migration within the SEMC, the dynamics of migration outside the region are more complex. Given the young and growing labor force of the SEMC and the aging population accompanied by low labor force growth in Europe, we can expect beneficial migration flows between the two regions. However, barriers to movement of workers remain high. Bilateral migration agreements between the two regions can be beneficial for both sides, giving Europe the young labor force it needs and helping the SEMC to decrease its growing population and unemployment pressures and to increase the remittances they receive. For deeper understanding of the situation, future/complementary research should analyze the impact of remittances on the countries of origin and the existence of the 'brain drain' and its effects.

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PART 3: SOCIAL DUMPING AND SOCIAL CLAUSE

CHAPTER 5: The Labor Side Agreement in NAFTA: an example to follow?

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In 1994, when it came into effect, the North American Free Trade Agreement (NAFTA) presented a specificity that has attracted much attention. It was a commercial agreement that created a free trade area between three disparate countries: the USA, Canada, and Mexico. The heterogeneous nature of the agreement obviously came from the introduction of this third country, and it is on this last point that we will focus. The Purchasing Power Parity Gross National Income (PPP-GNI) of Mexico was estimated in 2004 around 9640 dollars per capita, and the GNI per capita in current US dollars (converted using the World Bank Atlas Method) is around 6790 dollars. These figures are comparable to Poland's, which has a PPP-GNI per capita of 12730 dollars and a GNI per capita in US dollars of approximately 6100[26]. As a consequence, new European Union with 25 members presents at least the same kind of heterogeneity as NAFTA in 1994, and the same interrogation appears: shall we worry about the possibility of an unfair competition coming from the less developed members of the Union? After Ross Perot's fear of a "giant sucking sound" that could cause NAFTA as jobs go south[27], the French referendum campaign on the European Constitutional Treaty has shown that voters were worried about the "Polish Plumber" competition. The aim of this article is to study how this question was treated in the case of NAFTA. This is important in the Euro Mediterranean context because European Union could take the North American agreement as a starting point for the elaboration of a "social clause" in the EuroMed partnership.

The idea of an integration of Mexico in the Canada-USA bilateral agreement (ratified in December 1988) seems to have been a Mexican initiative in the beginning of the 1990's. In May of 1991, American congress allowed President Bush to negotiate the agreement using fast track procedure. The negotiations ended in August of 1992, when the agreement was signed by the representatives of the three countries, but the agreement

[26] These data come from World Bank: World Development Indicators 2005.
[27] See Perot and Choates (1993) or a summary at: http://www.issues2000.org/Archive/Save_Your_Job_Ross_Perot.htm

had to be ratified by national legislatures. At the end of 1992, President Clinton succeeded President Bush. The appropriateness of the ratification of NAFTA was a major point in the electoral campaign as it was criticized by Ross Perot, by the AFL-CIO (a coalition of Unions), and by environmentalist groups. In order to allow ratification of the agreement, President Clinton was induced to negotiate side agreements on Labor and Environment issues. In August of 1993 those side agreements were signed and introduced into the NAFTA text. In the second half of 1993, the Houses of Representatives ratified the agreement that came into effect in January 1994. In this paper we will show that the Labor side agreement is a compromise between NAFTA supporters and American unions, who were afraid that the social dumping exerted by Mexico would end up in the delocalization of thousands and even millions of American jobs, and in the downturn of the unskilled job's wage. We will examine if in the case of Mexico this suspicion of social dumping was justified (section 1). Then we will expose the claims and recommendations of the American unions on the social clause, and the content of the Labor side agreement which was a compromise between the partisans and opponents' points of view (section 2). At last, we will assess the Labor side agreement's first years of existence (section 3).

5.1: Mexico and Social Dumping

In the first section, we will show that Mexico has an advanced labor law. The second section will moderate this assertion, underlining that labor law is not enforced and explaining the reasons of this non-enforcement. And, finally, the third section will try to answer the question of whether Mexico was exercising a social dumping when NAFTA was signed.

5.1.1: Labor law in Mexico: an advanced law[28]

The originality of Mexican labor law is to have its founding principles in the Constitution of Mexico. The sixth part of the Constitution dating from 1917 is actually called "Of Work and Social Considerations" and it is composed of only one article, the 123rd article. This article is divided into two sections, dealing with private work contracts and civil servants contracts. Section A establishes certain rights, all the more revolutionary as they were granted at the beginning of the century:

- The working day is limited to 8 hours.
- Workers under 16 years old cannot be employed for unhealthy or dangerous tasks, they cannot work after 10 PM and their working day must be limited to 6 hours.
- Minors under 14 are not allowed to work.

[28] For further information on this section, see "Constitucion Politica de los Estados Unidos Mexicanos", several editions, and Anna Torriente (1995).

- A day-off must be allowed for six days of work.
- Pregnant women benefit from a 6 weeks maternity leave before birth and another 6 weeks after. They must be paid during this period a 100% of their normal salary and must keep their jobs after the maternity leave.
- Minimum wages must be established. They must be high enough to satisfy the basic needs of a family, from the material, social and cultural point of view, and they will be fixed by a national commission where employers, workers and government have representatives[29].
- Equal work for an equal salary, without taking in consideration sex or nationality.
- Minimum wage cannot be seized.
- Workers have the right to profit sharing from the firm where they work.
- Overtime hours are paid twice and cannot exceed three hours a day, they cannot be put three times in a row, and minors under 16 years old cannot be concerned by overtime.
- Employers must give a financial compensation to their workers in case of a work accident.
- Workers are allowed to create trade unions.
- Workers have the right to strike.

Furthermore, section B gives additional rights to civil servants, like 20 days-off a year and the access to a system of low rent or improved interest rate for mortgage loans.

This leads us to the following remarks:

a) As R. Pastor (1992) wrote: "Mexico has one of the most advanced labor laws on the continent, largely as a result of the Mexican revolution. Indeed, Mexico's social legislation has more in common with Europe's than with the United States (…) A comparison of Mexican, Canadian, and USA labor laws suggests that US labor unions would benefit the most from a harmonization of standards" (p. 187).

b) We can compare Mexican law to most usual propositions regarding the "social clause" like the Memorandum presented by Michel Giraud to the European Community Council in March 1995[30]. This memorandum presented four conditions to be satisfied when importing from a non-European country. These conditions are freedom of association, freedom of negotiation, banning of forced labor, and banning of child labor. We notice that Mexico follows and goes beyond the memorandum, if, however, we consider the nature of Mexican law and not the social practice[31].

5.1.2: Mexican labor law: a fictitious world?

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[29] At the date of the ratification of NAFTA, the minimum wage was around 3 US dollars a day in Mexico City.

[30] See "La Tribune Desfossés", March 27 and 28, 1995.

[31] Note that forced labour is dealt with in the second article of the Mexican constitution which forbids slavery in the national territory and also the 5th article that holds that "nobody can be forced to work without fair payment and without his own agreement, except as a punishment given by judicial authority"? The case of enslavement by debt is also treated by the article 123, section A, § 24, which establish that the worker's debt toward the employers cannot be handed down to the members of his family and cannot exceed a month of salary of the indebted worker.

If Mexican labor laws are exemplary, their application is much less. In regards to this subject, Pastor quotes Arturo Alcalde, a Mexican lawyer who, after a review of Mexican workers' rights, as stating: "You are in a world of science fiction. The theory is different from the practice" (Pastor, 1992, p. 188). This idea is confirmed by Moreau et alii (1994) who wrote: "in Mexico, the application of labor laws, presented by the authority as very protector, completely lacks effectivity" (p.10).

The reasons for the gap between the law and the practice are, on one hand, the importance of the informal sector, and on the other hand, the extent of corruption. The informal sector, by its very nature, escapes the authority vigilance, and so the more important is the informal sector and the less effective are the labor laws. In the 1980's, the informal sector in Mexico was estimated between 25 to 40% of the official GDP, according to a collective work made by the “Center of Economic Studies on Private Sector” (see the reference in bibliography). But the principal reason of the lack of enforcement of the law is the practice of corruption. As a matter of fact, Mexico seems to be a country in which corruption remains high. The Corruption Perceptions Index, calculated by Transparency International (see www.transparency.org) and which relates to perceptions of the degree of corruption as seen by business people and country analysts, gives the following values for Mexico (the index ranges between 10 - highly clean - and 0 - highly corrupt -):

Table 1: CPI Index for Mexico, by year

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
CPI	3.18	3.3	2.66	3.3	3.4	3.3	3.7	3.6	3.6	3.6	3.5

Source: www.transparency.org

In comparison, 2005 CPI scores for some European and Southern Mediterranean countries are indicated below:

Table 2: CPI Index for various countries, year 2005

Country	UK	Germany	France	Spain	Italy	Tunisia	Turkey	Egypt	Morocco
CPI	8.6	8.2	7.5	7	5	4.9	3.5	3.4	3.2

Source: www.transparency.org

There is another measure of corruption in Mexico realized by "Transparencia Mexicana", which is affiliated to Transparency International. This measure is the "Indice Nacional de Corrupción y Buen Gobierno" (National index of corruption and good governance) or INCBG. This index gives a percentage of times a bribe has been used to obtain a service. It is calculated for each State of the Mexican federal republic and for each kind of service. The highest values are obtained in the federal district of Mexico (22.6% in 2001 survey and 13.2% in 2003 survey) and the State of Mexico (respectively 17% and 12.7%). The mean value of the index is 10.5% in the 2001 survey and 8.5% in 2003, which signifies that one tenth of the services obtained in Mexico are obtained with a bribe. Obviously, those levels of corruption are not compatible with a good enforcement of the Law, and in particular the Labor Laws which are supposed to protect the poor. Furthermore, the corruption phenomenon seems to be prevalent in the trade unions, according to K. Ready (1993), who writes: "The Mexican labor hierarchy has a history of corrupt practices. They commonly receive higher wages or kickbacks, while union rank-and-file workers are forced to accept wages set by government and business development strategies" (p. 15). This is largely due to the predominance of the CTM ("Confederacion de los Trabajadores Mexicanos", i.e. Confederation of Mexican Workers), which is accused of being widely corrupt. A study made in 1996 (see *Migrant News*, May 1996) shows that the "independent" unions, i.e., those which are not affiliated to CTM, were in 1995 at the origin of 25% of the strikes that occurred in Mexico, while they represent only 10% of the unionized labor force (500,000 members against 5 million for the CTM).

As a result of those combined phenomena, and despite the fact that it is illegal in Mexico to hire children under 14 years old, it is estimated that 5 to 10 million children are employed in Mexico, often in hazardous jobs (K. Ready, 1993, p. 39).

5.1.3: Mexico and the "social dumping" accusation.

The main reason for adopting a Labor side agreement was the fear of a social dumping from Mexico in NAFTA. As a matter of fact, there are two aspects in "social dumping", one is related to the notion of intentionality and the other one is related to the low level of salary. In this section we will try to analyze this accusation and its fundaments, and will study hereafter these two aspects of the problem.

A) The "Oligarchy thesis"

In accordance with a first interpretation, "social dumping" supposes a deliberate action from the government to lower the cost of labor, by authorizing forced labor and/or work for children, and by forbidding collective bargaining in order to keep wages down. This would be done with a view to capture foreign markets and obtain foreign currencies. This idea, applied to the case of Mexico in NAFTA, has taken the form of what has been called the "Oligarchy Thesis". This thesis was formulated by Ross Perot in Perot and Choate (1993) but it also appeared in the argument against NAFTA by trade union representatives. The basic idea is that Mexican wages would be held down by an oligarchy of Mexican and US firms working together with the government of Mexico, the P.R.I. ("Partido de la Revolucion institucionalizada", i.e. "Institutionalized Revolution Party"), and the most important Mexican labor union, the CTM.

“In order to understand this point of view, it is necessary to remember that at the time NAFTA was signed, Mexico was still ruled by the P.R.I. The P.R.I. has been ruling Mexico since the Mexican revolution and most particularly since 1929, using different names (such as the P.N.R, or National Revolutionary Party, between 1929 and 1938, the P.R.M., or Party of Mexican Revolution, between 1938 and 1946, and the P.R.I. since

1946[32]), until 2000 when Vicente Fox, of the PAN (Partido Accion Nacional, created in 1939, catholic right-wing party) was elected President. The PRI has controlled in some ways the CTM since its creation in 1936. As Pastor (1992) wrote: "The enormous Confederation of Mexican Workers (…) is ostensibly stronger than US Unions, but in fact, the CTM power is more limited because of the nature of its bargain with the state. The latter has prevented any rival unions from competing with the CTM, which, in turn, has moderated demands for wage hikes and kept strikes to a minimum" (p. 187). Before 2000, it was natural to consider that Mexico was ruled by an oligarchy constituted by the PRI, the CTM, and the government."

When NAFTA was signed, the idea of its opponents was that this oligarchy, together with Major Mexican firms (Ross Perot spoke of "36 businessmen who (…) control 54% of Mexico's GNP" – see Perot and Choate, 1993, p.2) and with US firms that moved to Mexico (according to Perot and Choate, p. 12: "more than 1300 US companies (which) are operating more than 2200 factories in Mexico"), would use NAFTA to move US jobs to Mexico, which in turn would maintain wages as low as possible.

However, this "oligarchy thesis" is not consistent with Mexican history and is not sustained by the recent evolution of Mexican politics. As a matter of fact, the "complicity" between the PRI and the CTM appeared in the 1930's, in a period where international trade was not growing fast, and, after the Second World War, Mexico oriented itself to an import substitution development strategy, and not to an export-led growth. It is thus difficult to sustain the thesis of an oligarchy whose main goal is to attract foreign investment by maintaining low wages. Additionally, we can remark that until the 1990's, foreign investment was limited and controlled by the Law[33] and in some cases by the Constitution; some activities were reserved to the Mexican State and others only to Mexican private interests. Furthermore, in 2000, the PRI has lost its leadership over Mexico, and some analysts think that it was made possible by an improvement of democratic functioning, which in turn was the consequence of NAFTA[34]. So NAFTA seems to have had an opposite effect to the one described and dreaded by NAFTA opponents.

B) Wage costs and labor productivity

According to Faux and Lee (1993): "Contrary to the assertions in former President Bush's May 1 submission to Congress, the wage differentials between the United States and Mexico are not due to productivity differentials between the two countries. Harley Shaiken, of the University of California at San Diego, found that though a Mexican Ford engine plant was 80 percent as efficient as a US plant, workers were paid only 6 percent of US wages" (p. 103). In response to this argument, NAFTA supporters like Hufbauer and Schott argued that "on average, high US labor productivity

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[32] See Luis Javier Garrido (1986).

[33] See for example N. Lustig (1992). The 1973 Law "for the promotion of Mexican investment and regulation of foreign investments" was reserving certain activities to Mexicans (radio, TV, and all kind of internal transportation) and was limiting for most other activities the share of foreigners to 49%.

[34] It was the thesis of Schott and Hufbauer (1992), eight years before the change of the ruling party, when they were writing: "economic pluralism obviously plays in favour of political pluralism (…) even if democratic tradition is not yet deeply rooted in Mexico, it seems that it is taking root" (p. 283). The argument was previously made by a former president of Singapore who said that "economic development leads inexorably to political opening". About the links between economic modernization and political opening in Mexico see Grayson (1993).

pays for high US wages. The US worker earns high wages because of his high output, which in turn reflects his work skills, his complement of sophisticated capital equipment, and the highly articulated infrastructure of the US economy" (Hufbauer and Schott, 1993, p. 13). These authors illustrate their argument by a study realized on Mexican maquiladoras:

Table 3: Wage Costs and Labor Productivity USA/Mexico

	Mexico (maquiladoras)		USA (industry)		Comparative ratio	
Years	Value added per employee in $ (1)	Average hourly compensation per worker in $ (2)	Value added per employee in $ (3)	Average hourly compensation per worker in $ (4)	(1)/(3)	(2)/(4)
1975	4940	1.44	24177	6.36	20.4%	22.6%
1982	6698	1.9	43164	11.68	15.5%	16.3%
1984	5784	1.54	51415	12.55	11.25%	12.3%
1986	5183	1.10	56366	13.25	9.2%	8.3%
1988	6323	1.25	65928	13.91	9.6%	9%
1991	8818	1.95	72740	15.6	12.1%	12.5%

Source: Hufbauer and Schott (1993), p. 172 and our calculations.

The proximity between the figures in the two last columns seems to demonstrate that the differences between salaries in Mexico and in the USA are essentially due to differences in productivity. So, if we try to draw a conclusion from what we have seen in subsection 1.3, we could say that no proof has been brought that Mexico was exerting a "social dumping" in its relation with the United States. Nonetheless, the demands of the labor unions have led the government of Bill Clinton to sign a Labor side agreement, as we will see in the next section.

5.2: The claims of labor unions and the content of Labor Side Agreement (North American Agreement on Labor Cooperation, or NAALC)

During NAFTA negotiations, and even more between its signing in August 1992 and the ratifications by the U.S. Congress on November 17, 1993, lobbies have enunciated claims about environmental and social aspects of NAFTA. The Conference held in Minneapolis on November 19-20, 1991, and entitled "NAFTA: Labor, Industry, and Government Perspectives" (see the book edited by Bognanno and Ready (1993) based on the contributions to this conference), and articles published in *Challenge*[35], are some expressions of these claims. Essentially, these lobbying groups, which represented ecologists and labor unions, were concerned by the possibility of social and environmental dumping. They were generally opposed to the ratification of the global Agreement, and most of them did not believe that it was possible to amend the Treaty so that it could be acceptable. So, they generally opposed the elaboration of "side agreements" in order to compensate the defects of the text, and favoured rejecting the agreement altogether. Their opinion can be summarized by the assertion of J. Faux: "Finally, can we fix NAFTA with side agreements? I am sceptical, but the President wants to try. At the very minimum, fixing it is going to require tough enforcement standards on labor and the environment – including a path to harmonization of minimum wages in the export sectors. It's also going to require an independent tri-national commission to enforce those standards." (Faux, 1993, p. 8).

As far as labor is concerned, the propositions formulated by the AFL-CIO and the MODTLE (Mobilization on Development, Trade, Labor, and the Environment) were to incorporate in the Agreement the following points:

- Enforcement of the rights of free association and collective bargaining
- The right to strike
- Non-discrimination against unionized workers
- Equal remuneration for work of equal value
- A mechanism whereby infractions of labor rights in production for export can be challenged by trade union or individuals of *any country* of the free trade area
- existence of a "decent" minimum wage in the countries which belong to the area
- A program to eradicate child labor
- a mechanism whereby companies that invest in other countries contribute to support social infrastructure in the country in which they operate, including in areas such as medical care or education.
- The possibility of sanctions against the countries that do not respect the point previously exposed

The Labor Side Agreement, officially called the "North American Agreement on Labor Cooperation" (NAALC), does not satisfy these claims. Hufbauer and Schott (1993) quote (p. 159) on this subject M. Lane Kirkland, President of AFL-CIO, who qualified this text of "bad joke" and who said that it was a "structure of committees all leading nowhere" (declaration made in The Washington Post, 1 September 1993). That's why the side agreement negotiated by government Clinton did not disarm the opponents to the Treaty. On November, 7, 1993, ten days before the vote of the Treaty, President Clinton denounced the pressure made by the trade unions against NAFTA ratification and recognized that he needed 30 more votes to have majority in the Congress. It was only after the debate between Al Gore and Ross Perot that the victory seemed attainable for the partisans of the Agreement. On November 14, US Ambassador in Mexico forecasted that the treaty would be adopted by a lead of two votes. At last, on November 17, the

[35] See S. Friedman: "NAFTA as social dumping", Challenge, September – October 1992, J. Faux: "The NAFTA illusion", Challenge, July – August 1993, and Koechlin and Larudee: "The High Cost of NAFTA", *Challenge*, sept.-oct. 1992.

Agreement was adopted by 234 votes in favour and 200 votes against the Treaty. Among the democrats, there was 102 "yes" and 156 "no" and in the Republican party 132 "yes" and 43 "no".[36]

What is the content of the Labor Side Agreement?[37]

Essentially, the goal of the Labor Side Agreement is to ensure the effective enforcement of its own national legislation by each country (especially Mexico). It by no means intends to impose to the countries' minimal norms of workers' protection. The side Agreement defines in Annex 1 "labor principles" that constitute "guiding principles that the Parties are committed to promote, subject to each Party's domestic law, but do not establish common minimum standards for their domestic law". These guiding principles are the following:

1. Freedom of association and protection of the right to organize
2. The right to bargain collectively
3. The right to strike
4. Prohibition of forced labor
5. Labor protections for children and young persons
6. Minimum employment standards (such as minimum wages and overtime pay)
7. Elimination of employment discrimination
8. Equal pay for women and men
9. Prevention of occupational injuries and illnesses
10. Compensation in cases of occupational injuries and illnesses
11. Protection of migrant workers

The questions related to principles 4 through 11 are named "technical labor standards".

The agreement establishes a Commission on Labor Cooperation, which is constituted by a ministerial council, a secretariat, and a National Administrative Office structure. The ministerial council is constituted by the Labor ministers of the parties or their designees. Each country must establish a National Administrative Office (NAO), which is a point of contact with other governmental agencies of the country, the NAO of other two Parties of the Agreement, and the Secretariat of the Commission. The NAO has the important role of receiving the complaints related to violations of labor rights and to transmit them to the tri-national structure. Each country determines its own domestic procedures[38] but the NAALC establishes in article 16 that "each NAO shall provide for the submission and receipt (…) of public communications on labor law matters *arising in the territory of another Party*". All the points defined above can be the subject of consultations at the ministerial level. However, only the "technical labor standards", which are moreover

[36] See "Cronologia economica y TLC", Supplement in Mexican newspaper "Excelsior", 19 December 1993.
[37] For the text of the NAALC, see http://www.worldtradelaw.net/nafta/naalc.pdf or on the web site of the NAALC: http://www.naalc.org/ .
[38] For the procedure of the NAO in the United States of America, see the website: http://www.dol.gov/ilab/programs/nao/procguide.htm. The U.S. NAO states that "any person may file a submission with the Office regarding labor law matters arising in the territory of another Party".

"trade related"[39], can be the subject of a request transmitted to the Evaluation Committee of Experts (ECE). No ECE can be convened if the matter is not trade related, if it is not related to a violation of "technical labor standards", or if it is not a lack of enforcement of an existing labor law.

Table 4. Stages in NAALC process for each principles

Stages	Principles
Fines or Suspension of NAFTA Benefits Arbitral Panel Post-ECE Ministerial Consultations	11. Safety and Health 10. Minimum employment standards (minimum wage) 9. Child labor protection
Council Review of ECE Report Evaluation Committee of Experts	8. Migrant worker protection 7. Workers' compensation 6. Equal pay 5. Non-discrimination 4. Prohibition of forced labor
Ministerial Consultations NAO Review & Report	3. Right to strike 2. Right to bargain collectively 1. Freedom of association / right to organize a union

After the presentation of the final report by the ECE and only in questions related to the enforcement of a party's occupational safety and health, child labor, or minimum wage technical labor standards, the fifth part of the agreement provides a procedure which can lead to fines and trade sanctions. As a matter of facts, if it is not possible to find a mutually agreeable resolution of the matter, the ministerial council can decide, by a two-thirds vote, to convene an arbitrary panel composed of independent experts in labor law, resolution of disputes arising under international treaties, or any other relevant speciality. The arbitrary panel must determine if there has been a "persistent pattern of failure" in the enforcement of the labor law. The labor law considered must be a national existing law of the country in question. Furthermore, it must be a "trade related" matter and it must be related to occupational safety and health, child labor, or minimum wage. The arbitrary panel must, when appropriate, formulate recommendations, which are normally that the country adopt and implement an action plan sufficient to remedy the pattern of non-enforcement. Then, the disputing Parties may agree on a mutually satisfactory action plan, which normally is in accordance with the recommendations of the panel. If the disputing parties have not agreed on an action plan (case a) or if they cannot agree on whether the party in question is fully implementing the action plan (case b), any disputing party may request that the panel be reconvened by the council. In the case of (case a), the arbitrary panel must establish an action plan consistent with the law of the party in question. In the case of (case b), the panel must determine whether the party in question is fully implementing the action plan. When the country in question is not implementing the action plan, the panel can impose a monetary fine. The fine cannot exceed 20 million dollars the first year and, in subsequent years, it cannot exceed 0.007% of total merchandise trade between the parties the preceding year. As a final step, if a party fails to pay a monetary enforcement assessment, the complaining party may suspend the application of NAFTA to the country in question. The trade sanctions

[39] By "trade related", article 49 means "related to a situation involving workplaces, firms, companies or sectors that produce goods or provide services traded between the territories of the Parties; or that compete, in the territory of (a) Party (…) with goods or services produced or provided by persons of another Party".

that could be applied in this case are limited to the withdrawal of NAFTA benefits and cannot exceed the original fine[40].

As observed by Hufbauer and Schott (1993), this is equivalent to distinguish three kinds of labor issues:

a) the areas that can be the subject of fines an trade sanctions, which are occupational health and safety, child labor, and minimum wage;
b) the areas that can only be the subject of official consultations and reviewed by the ECE (which are all other "technical labor standard" matters);
c) the matters that can only be examined at the ministerial level: the rights to strike, to bargain collectively, and to freely associate and organize.

Article 49 emphasizes the following point with respect to the first group of matters: "For greater certainty and consistent with the provisions of this Agreement, the setting of all standards and levels in respect of minimum wages and labor protections for children and young persons by each Party shall not be subject to obligations under this Agreement. Each Party's obligations under this Agreement pertain to enforcing the level of the general minimum wage and child labor age limits established by that Party".

Moreover, the Labor side agreement contains a commitment from the three countries of ensuring public information related to their labor laws and promoting public education regarding its labor law. The three countries commit themselves taking measures that ensure the enforcement of their labor laws, such as:

- appointing and training inspectors,
- monitoring compliance and investigating suspected violations, including thorough on-site inspections,
- encouraging the establishment of worker-management committees to address labor regulation of the workplace.

In summary, the goal of the labor side agreement is to ensure the effective enforcement of each country's labor law. This can be interpreted as an implicit recognition of the quality of each country's laws, or as the expression of the desire to not intervene in questions that are the concern of national sovereignty. The Preamble of the NAALC insists on the "continuing respect for each Party's Constitution and Law" of the three governments that are contracting the Agreement. This kind of agreement is therefore not applicable to countries that do not already have an advanced labor law, since it is based on the idea that it is sufficient to ensure the enforcement of existing laws and that it is not necessary to impose international labor standards. This Agreement is interesting because it shows respect for the sovereignty of all Parties, but the American trade unions would have wished to impose minimal social norms and they would have desired a broader

[40] Trade sanctions do not apply to Canada. If Canada is the Party complained against, the decision of the arbitrary panel will be presented by the Commission to a Canadian Court, which will convert the panel decision into an order of the Canadian Court, without any modification. Canadian Court will thus ensure that the action plan is implemented or that the fine is paid.

recourse to sanctions (fines and trade sanctions) as this recourse is limited to three areas out of eleven in the existing agreement.

5.3: An Assessment of Labor Side Agreement's First Decade

5.3.1: NAALC Ten Years Later: An Assessment

Ten years have passed since NAALC entered into force and it is still complicated to provide an accurate assessment of its outcome. Opinions on the issue are contradictory although they clearly tend to highlight the failure of the agreement.

In order to assess the results, it is essential to study the reasons that propelled the NAALC approval and its incorporation into NAFTA. Briefly discussed above, the roots of this labor cooperation agreement principally lie in:

- The improvement of labor conditions.
- The expansion of workers' rights.
- The increase in tri-national cooperation and the quality and productivity of labor.

Nevertheless, behind these arguments lies American and Canadian anxiety about a considerable portion of their multinational business using NAFTA as an exit toward a country with lower salaries and less stringent labor laws, with the resulting loss of employment and investment in their own countries.

There are also concerns that NAFTA will lead to a "least common denominator" effect with regard to labor laws, which would constitute a serious problem especially for Mexican workers who would not improve their situation. In addition, labor standards in the United States and Canada would be jeopardized if they were to fight to maintain the companies at the cost of losing ground on labor rights or if they were to contract Mexican immigrant workers to solve this conundrum.

In practice, it has effectively been Mexican workers, specifically those that work in Maquiladoras and the immigrants in the United States, who have made the most demands before the NAALC. Indeed, they have borne witness to the shortcomings of the agreement resulting from the failure of the consultation and arbitration processes provided for by NAFTA.

Notwithstanding the aforementioned assessment, there are winners and losers from NAFTA and the NAALC as in any other multilateral agreement. So-called North-South Agreements[41] generate costs and benefits arising from the fact that the exchange of goods and services is ultimately an exchange of production factors, including labor. Table 5 introduces the winners and the losers according to the sector under analysis.

Table 5. Winners and Losers in a Developed Country under three conditions of trade with developing country

	WINNERS	LOSERS
I. Potential Effects of Trade Liberalization (Example: NAFTA)	Higher-skill, higher-tech businesses could benefit from reduced trade barriers. Labor intensive businesses that relocate to the country of the trading partner could benefit by reducing production costs. Domestic businesses which use imports as components into the production process may save on production costs	Labor-intensive lower age import-competing businesses could lose from reduced protections (tariffs) on competing imports. Workers in import competing businesses could lose if their businesses close or relocate.
II. Potential Effects of Trade Liberalization Modified by Worker Rights Adherence	Adherence to worker rights requirements could raise foreign labor costs slightly, making U.S. imports more competitive. Consequently, workers in import-competing businesses could be under less pressure to either give back wages or have their worker rights protections threatened	On the other hand, some multinational corporations wanting to relocate to the developing country to save on labor costs could be discouraged from doing so because worker rights adherence could increase their production costs.

[41] The North-South label has been used to identify agreements between developed and developing countries. It is worth pointing out that this label nowadays does not follow a geographical line but it is rather used to distinguish agreements signed by economies that enjoy different degrees of economic development.

III. Real-Life Example: Effects of Trade Liberalization (i.e., NAFTA) Modified by Worker Rights Adherence Under NAALC	NAALC's worker rights effects so far have been sufficiently mild. In the end, it is more like winners and losers from trade liberalization than trade liberalization modified by worker rights adherence.

Source: Bolle (2002), p. 14.

It is crucial to highlight that conditioning the free exchange of goods, services, and capital to the protection of labor rights could be used to mask protectionist policies by both the developed country (positive and negative conditionalities[42]) and the developing country (maintenance of comparative advantages). It is obvious, therefore, that the reasons that propel the incorporation of a labor clause into a trade agreement are far from clear.

5.3.2: Some reasons for the failure

The lack of common labor rules among the three signatory states is the ground for the vast majority of criticisms. Even though the NAALC contains eleven general principles that compile minimum mandatory standards for the three countries, the regulations are heterogeneous depending on each national legislation. In fact, of the three countries, Mexico enjoys the most complete labor legislation while it is the one that enforces it the least.

NAALC critiques can be classified under two general categories: those that refer to the structure of the agreement and those that point to the specific situation of the countries involved.

A) Critiques Based on the Structure of the Agreement.

The North American Agreement on Labor Cooperation is the result of the development of a complex system of complaints resolution (see Table 4). The procedure must complete the seven steps defined in the previous section. Moreover, all complaints should be originated on the persistent non-compliance with any of the general principles defined in the Agreement. However, not all the violation cases of principles run through the seven steps. To be sure, only the violations related to safety and health at the workplace, minimum employment standards, and child labor protection can result in fines or suspensions. During the first years of NAALC, most of the complaints were related to restrictions on the right to freedom of association[43]. Given that these claims could only reach the ministerial consultations, complaints on safety issues, health, and

[42] Positive conditionalities refer to an easier access to the developed country market if there is compliance with labor regulations. On the other hand, negative conditionalities refer to the punishment infricted on the export sector of the country that does not comply with the aforementioned regulations.
[43] Two thirds of the claims were related to the violation of general principle number one.

employment discrimination were added. These claims are subject to the Evaluation Committee of Experts and Arbitral Panels and could result in trade sanctions.

Table 6 shows violations of the NAALC principles brought before each of the national NAOs. The numbers in square brackets correspond to the following principles: [1] Freedom of association and protection of the right to organize; [2] the right to bargain collectively; [3] the right to strike; [4] prohibition of forced labor; [5] labor protections for children and young persons; [6] minimum employment standards; [7] elimination of employment discrimination; [8] equal pay for women and men; [9] prevention of occupational injuries and illnesses; [10] compensation in cases of occupational injuries and illnesses; and [11] protection of migrant workers.

Table 6. Summary NAO's Public Communication

Against … Public Communications	CANADA	MEXICO	UNITED STATES
NAO Canada		Canadian 98-1 [1; 9] Canadian 2003-1 [1; 2; 6; 9] Canadian 2005-1 [1; 2]	Canadian 98-2 [11; 6] Canadian 99-1 [1]
NAO Mexico			Mexican 9501 [1] Mexican 9801 [1; 2; 6; 9] Mexican 9802 [1; 6; 9; 11] Mexican 9803 [11; 9; 6] Mexican 9804 [11; 6] Mexican 2001-1 [10] Mexican 2003-1 [11; 6; 10] Mexican 2005-1 [4; 6; 7; 8; 9; 10]
NAO United States	US 9803 [1] US 9804 [1; 2; 9; 10]	US 940001 y 940002 [1] US 940003 [1] US 940004 [1] US 9601 [1] US 9602 [1] US 9701 [8] US 9702 [1; 9; 6] US 9703 [1; 2; 9] US 9801 [3] US 9802 [5] US 9901 [1; 2; 6; 9] US 2000-01 [9; 10] US 2001-01 [1; 2] US 2003-01 [1; 2; 6] US 2004-01 [6; 9] US 2005-01 [1;2; 3] US 2005-02 [1; 2] US 2005-03 [1; 2; 4; 5; 6; 7; 9]	

Source: US DEPARTMENT OF LABOR, BUREAU OF INTERNATIONAL LABOR AFFAIRS; Status of submissions under the North American Agreement on Labor Cooperation (NAALC); in web http://www.dol.gov/ILAB/programs/nao/status.htm#iia20 (updated May, 2006).

Once plaintiffs have filed their complaint before the corresponding NAO, they lack access to the NAALC set-up mechanisms resulting in another common criticism of the agreement; its lack of transparency. Both workers and their representatives have expressed their dissatisfaction with their inability to openly participate in the process. At any given moment, the plaintiffs are neither informed about the complaint status, nor consulted about particular questions related to the situation that propelled the claim.

Moreover, the process is long and barely systematic regarding due dates for each of the steps. As a result, the workers involved are discouraged from filing new claims. In fact, up to now none of the filed complaints have reached a final resolution that involves trade sanctions.

Also, some multinationals' actions have exhibited non-compliance with workers' rights such as illegal dismissals, lack of freedom of association, infringements that endanger workers' health and safety, and lack of interest to develop collective bargaining. None of the procedures in place have restored the rights violated by businesses. This fact stands out clearly if we compare it with the enforcement of the investors' defense clauses included in NAFTA's chapter 11. [44]

Workers whose labor rights have been violated have criticized the lack of government action against those firms that have not complied with the general principles contained in the NAALC.

B) Critiques Based on the Specific Situation of each of the Signatory States

An assessment of the specific situation of each of the three signatory states requires a macroeconomic analysis.

Table 7 shows the uneven situation of Mexico as compared with its partners. The investment needs of this economy together with the lack of qualified labor and the high level of external debt have resulted in Mexico's opening to foreign capital. Specifically, foreign direct investment has enabled the country to fulfill its external debt payments on interests and principal. The flexibility of the Mexican labor laws has encouraged the arrival of a large number of multinationals and maquilas that hire cheaper labor and take advantage of tariff-free imports of intermediate products and capital goods.

This situation creates a dilemma for Mexican authorities who have to decide between applying labor laws more strictly and allowing the entrance of multinationals that enable the economy to grow in a context of high levels of external debt.

The quandary is aggravated by the high levels of corruption that govern the country. No government has allocated enough resources to fight fraud and bribes. There has been a persistent lack of political will to emerge from an institutional crisis that hinders Mexico's adjustment to international standards.

Table 7. Macroeconomic Indicators

[44] NAFTA signatories are binded by the general principle of non-discrimination for investors and investments. This principle is two-folded including the national treatment clause (each party agrees to accord the other parties treatment no less favourable than it accords to its nationals) and the most-favored- nation clause (each party accords to the other parties treatment no less favorable than it accords to third parties under favorable circumstances, articles 1102 and 1103). Also, article 1106 includes specific measures that forbid restrictions to foreign direct investment as well as performance requirements.

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	1994			2004		
	Canada	**Mexico**	**US**	**Canada**	**Mexico**	**US**
GDP[1]	555.860	420.780	7.017.500	977.968	676.497	11.711.834
GNI per capita [2]	19.960	4.590	26.630	28.310	6.790	41.440
Inflation, GDP deflator[3]	1,2	8,3	2,1	3,0	6,1	2,6
Unemployment rate[4]	10,5	4,4	6,2	7,3	3,1	6,2
Employment[5]	67,0	58,7	72,0	72,5	60,8	71,2
Gross capital formation[6]	19,2	21,7	18,1	17,9	21,3	16,9
Trade [6]	67,6	38,5	21,9	72,7	62,0	23,7
Exports of goods and services[6]	34,4	16,8	10,3	38,3	30,1	9,6
FDI, net inflows(BoP)[1]	8.224	10.973	46.130	6.284	17.377	106.831
External debt, total (DOD)[1]	..	138.550	..	..	138.689	..
Total debt service [7]	..	4,9	..	..	7,7	..
Total debt service[8]	..	25,7	..	..	23,0	..

Source: WORLD BANK, World Development Indicators database, 2005. OECD, Employment Outlook, Statistical Annex, 2006.

[1] Current US $, millions
[2] Current US $, Atlas method
[3] Annual %
[4] % of total labor force
[5] Employment/population ratio, persons aged 15-64 years (%)
[6] % of GDP
[7] % of GNI
[8] % of exports of goods and services

On the other hand, the US government has been absorbed by the fast-track debate that took place after the NAALC entered into force. While the reach of the Trade Promotion Authority (TPA) is not vital, it is clear that the approval of such authorization has an impact on any trade agreement that involves the United States. The NAALC was negotiated through a fast-track procedure (formerly the TPA) that expired in 1994.

The use of fast-track may have an impact on several issues related to the negotiation of an agreement between the United States and third parties. To be sure, the US President could decide to widen or to narrow the protection of workers' rights incorporated into any trade agreement. The relevance of this decision has a long-term impact on the multinationals' protection of labor rights.

The key point of this process is that TPA suppresses Congress' right to amend agreements limiting its decision making power to pass or reject the trade agreement already negotiated by the executive branch. This procedure enables a much faster approval of the agreement.

A 1988 law authorized the President to include workers' rights provisions into trade agreements negotiated under fast-track. Both the House and the Senate partially restricted the fast-track by including different types of objectives for the negotiations. In this sense, only the main objectives could be included in a trade agreement negotiated under fast-track. The arguments used in favor of such restriction were:

- Trade agreements enjoy a more rational framework since they focus exclusively on the traditional trade aspects.
- The use of labor standards as disguised barriers to trade is prevented.
- It enables economies to develop according to their comparative advantages.

It is in this sense that it becomes relevant that the NAALC was negotiated under fast-track leaving no room for the introduction of amendments or for the debate regarding the limitation of the super-powers in trade issues of the U.S. President.

5.3.3: The Positive Aspects of the Agreement

Not every aspect of the Agreement and its application has been adverse. A large number of those involved agreed on the progress made especially on what has been labelled as the “sunshine effect” which refers to improved dialogue between the three signatories. Border cooperation has also been boosted as a result of the Agreement.

The “sunshine effect” reveals NAALC’s ability, through the complaints filed, to make public certain situations that would have been otherwise unknown. In fact, each of the claims have clearly shown the shortcomings of several Mexican maquilas and some US firms that hire Mexican illegal immigrants to perform jobs that jeopardize their health (use of chemical products without security procedures in place, electrical security problems in the equipment used, excessively long work-days performing repetitive tasks that require extreme physical effort resulting in injuries)[45]. The role played by NGOs, trade union representatives, the media, and, in general, civil society allows society to be aware of the multinational corporations’ serious actions.

At the same time, NAFTA signatory governments are forced to strengthen the political dialogue due to pressure exerted by the aforementioned groups. In this sense, the tri-national political dialogue will enable each government to enjoy more accurate information about the violations and the measures to be implemented in response. The public availability of information about particular infringements and labor law violations allows for pressure to be put on the firms that break the law. As a result, governments, civil society, and NAALC’s mechanisms become efficient intermediaries between workers and their representatives, and the firms. However, the effectiveness of the dialogue among the different social sectors will depend on the financial and human resources allocated to the compliance with the NAALC basic principles. Moreover, the individual countries attitude towards the agreement is also crucial for the positive results of dialogue enhancement. We should not forget that each country is free to assign the resources that they deem appropriate for the protection of its workers’ rights.

Finally, the third positive outcome associated with the labor agreement is border cooperation. Solidarity across borders has improved as a result of the peculiar features of the complaints’ procedure; a claim by one country’s workers must be filed in the country that has infringed labor rights. As a result, an organized cross-border network that would enable information exchange and communication between transnational unions of firms accused of non-compliance and each country’s NAO could be created.

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[45] Delp, L., M. Arriaga, G. Palma, H. Urita, and A. Valenzuela: Nafta's Labour Side Agreement. Fading into Oblivion? UCLA Center for Labor Research and Education. March 2004. (available at http://www.labor.ucla.edu/publications/nafta.pdf)

5.3.4: The NAALC. Lessons learned

The analysis undertaken enables us to reflect on the lessons learned from the NAALC that could be applied to trade agreements, especially for those between countries with different degrees of economic development. It is certainly in these cases that the problems associated to the agreements are more pressing.

Agreements that incorporate labor clauses or rules should not originate in the core countries aiming to extend the guidelines through the periphery. The interest of the more developed countries cannot be based in the acceptance of low labor standards that, at times, do not even comply with the International Labor Organization rules. Rule harmonization must be based on a bottom-up approach. There should be an agreement on "good conduct or good government" that proscribes foreign investment from exploiting social comparative advantages based on the lack of supervision by the less developed countries' governments.

Moreover, developing countries should not look at foreign investment as the panacea that will solve their macroeconomic unbalances. More specifically, those economies that suffer from high levels of external debt should not count on foreign capital to cover for their interest and principal payments on their debt. To be sure, this approach could result in a lax discipline regarding the enforcement of labor rules seeking to keep the multinationals within the country. In fact, it is convenient for developed countries to undertake "compliance assistance" with the developing economies. Compliance assistance should include not only financial resources, but also technological, technical, and cross-border resources that enable host economies to take advantage of foreign capital from both the social and the economic perspective. Regarding speculative capital inflows (that flow to particular countries attracted by relatively flexible social and environmental protection rules), some authors have suggested the adoption of a "Tobin Tax." A "Tobin Tax" would guarantee the protection of those workers employed by corporations that are willing to move to emerging markets when labor regulations become stricter.

What is clear is that any trade agreement that incorporates labor clauses should include the opinion of the agents involved. Both workers and trade unions should play a key role in the development and functioning of the agreement. Any violation of the guiding principles of the agreement should be the object of debates, monitoring, examination, and sanctions that, if needed, should be supervised by a supranational committee. The guidelines and recommendations of such committee should be mandatory for firms and governments depending on who the offender is.

Moreover, our own opinion is that no labor agreement incorporated into a trade agreement should be signed as a parallel annex, but rather it should be integrated as a whole. In this sense, the trade agreement should guarantee the protection of the workers' fundamental rights for both national and immigrant workers. The feasibility of such agreement is grounded on the existence of enough political will to adopt a set of minimum immigration standards common for all the signatory parties.

It is necessary, therefore, that the free movement of goods is accompanied by a free movement of workers that guarantees homogeneous labor standards and a common immigration policy, the free provision of services and the free movement of capital, especially that of long-term capital that encourages economic development. This is not the case in NAFTA. It is obvious that our proposal embraces the creation of a common market that would result in the loss of national sovereignty in certain issues. This approach is related to the geographical distance between the countries that would form the common market. For example, within the context of the US-Chile and US-Jordan FTAs[46] the incorporation of labor agreements would exhibit different reasons than those that propelled the NAALC given the differences in geographical distance between the countries that form the three agreements. In the later case, the closeness between the signatory countries magnifies the aspects of the labor agreement.

In conclusion, globalization has created a "fictitious opening" of borders for firms that seek to exploit comparative advantages. In this sense, multinationals could be attracted by economies with lax labor rules or could force workers to migrate.[47] Both issues could generate risks. In the former case, countries that attract investment propitiated by low labor rule enforcement could jeopardize the adoption of stricter labor rules and enforcement. In the later case, advanced economies could see this as an advantage to hire immigrant workers who are willing to work for lower salaries and under precarious labor conditions. Both cases could result in a geographical movement of comparative advantages. To be sure, countries that have traditionally been recipients of foreign capital flows could lose ground to other emerging economies. This could be Mexico's case if US capitals were more attractable by the comparative advantages offered by hosts such as China.

Table 8. NAALC critiques and proposals for improvement

CRITIQUES	PROPOSALS FOR IMPROVEMENT
It is parallel to the trade agreement and not incorporated within it while is not mandatory for the signatory countries	• Incorporate both the labor and the environmental agreements to NAFTA • Set up monitoring and supervising mechanisms
There is no common set of labor rules for the signatory countries. Each country maintains its own labor rules	• Creation of common union regulations for the three countries • Set up a supranational entity that regulates and monitors the enforcement of labor rules. These labor rules should be harmonized by a bottom up approach
Trade and investment clauses have supranational features while the labor and environmental agreements are exclusively national and without harmonization	• Labor and environmental issues should have the same treatment as intellectual property and trade in goods issues • Encourage the creation of a North American common market that ensures the free movement of goods, services, workers and capital

[46] The US agreements with Chile and Jordania are more recent than NAFTA and, therefore, difficult to compare. Not only these agreements incorporate liberalization measures and procedures more relevant to the current needs of these economies, but the differences in geographical distance widens the difference regarding the economic and social disparities between the signatories involved. Moreover, the agreements' objectives are also divergent.

[47] This is especially the case of resource-seeking investment. The objective of this type of capital is to enjoy lower costs therefore obtaining competitive advantages. The Mexican maquilas serves as an example of such investment.

The eleven general principles contained in NAALC are just minimum standards	• The eleven general principles should be mandatory and based on: ✘ "Declaration on the Fundamental Principles and Rights at Work", ILO ✘ "Declaration of Principles Concerning Multinational Enterprise and Social Policy", ILO ✘ "Declaration and Decisions on International Investment and Multinational Enterprises", OECD
Only three principles are subject to trade sanctions and penalties (safety and health; minimum wage; child labor protection)	• The eleven principles should be subject to the evaluation of ECE. Violations should be subject to trade sanctions
Lack of labor standards harmonization	• Create a code of good conduct • Strengthen the enforcement of labor codes through annual auditings that include periodical inspections of labor conditions and salaries
Long and opaque procedure (low degree of workers' involvement in the process)	• Shorten the communications and arbitrage deadlines • Establish deadlines for each of the stages of the process • Allow workers and trade unions to engage in the process so as to ensure transparency • Develop mechanisms that enable workers' to protect their labor rights
There are no sanctions for governments and/or firms that violate labor rules	• Both governments and firms should be subject to sanctions if they violate any of the general principles • If sanctions are adopted, the following options should be considered: Increase the sanctions already contained in NAALC ✘ Increase the limits imposed on firms who are accused of violating the general principles ✘ Limit the ability of firms that violate labor laws to sell their products
There are no permanence requirements for FDI	• Adoption of a "Tobin Tax" that enables economies to discriminate between speculative and productive capitals and to monitor potential abuses of the comparative advantages of the host economies regarding labor issues
The parallel labor agreement does not include an immigration clause. Each of the signatory countries maintains sovereignty over the immigration policies	• Set up of a Trinational Immigration Policy that respects national identity
The use of the TPA by the US government in the design and approval of labor cooperation agreements	• Harmonization of approval procedures for these type of agreements • Specify the body of government that is authorized to negotiate the agreement • Approval and ratification by the national parliaments

5.3.5: Final Remarks and Insights for Future Trade Agreements

In closing, we have a few final remarks. First, is it reasonable to incorporate a labor agreement to a trade agreement when there is a significant gap in the development levels of the signatory countries?

Yes, we believe that a labor agreement could be a vehicle for reducing that gap if and only if the special conditions of the less developed economy are taken into account. Regional integration schemes exclusively designed by the North should be avoided.

Second, should the NAALC be reformulated given its dubious results?
Since the NAALC is already in place, our advice is to learn from the mistakes and to strengthen the role of the agreement.

And, finally, how can the role of the NAALC be strengthened?
To strengthen the role of this agreement it is necessary to improve its dispositions. Such improvement could be undertaken from a double approach. First, the agreement could become a mechanism for the resolution of labor disputes. In this sense, the agreement would become a tool to monitor the compliance with labor standards and it would include all the affected agents. Secondly, it could become a vehicle to improve cross-border cooperation. Both approaches should be accompanied by the political will of the involved governments to advance towards more rational and better labor standards.

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CHAPTER 6: Could fear of the "Polish plumber" extend to Tunisian workers?

A legal approach to movement of workers and services between France and Mediterranean countries

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In the spring of 2004, the story of the "Polish Plumber"[48] played a great part in the outcome of the referendum in France designed to ratify the treaty establishing a European constitution. In fact, the final French "no" led to the adjournment sine die of the constitutional treaty.

The image of the "Polish Plumber" was clear for everyone, but the reality was harder to define. Public opinion has not been very concerned with the legal mechanisms by which a Polish plumber could come to France to work without being subject to French law. In fact, no one seems to have considered all the concrete parameters which need to be taken into account: language and cultural barriers, skills, natural migration patterns, etc. Although no serious debate has taken place in France, the spectre of illegal work was surely hiding behind the "Polish Plumber". Could an invasion of Polish plumbers also be the result of legal constructions permitted and encouraged by European Union (EU) rules? Many in France believed that through the constitutional treaty, which was supposed to lift commercial barriers between Member states, workers would move more easily within the EU area and, as a result of the deliberate lack of controls in an open market, be able to ignore French laws and threaten the French social model. The other target of French nationals was the "Bolkestein directive"[49] – which in fact was only at the stage of a proposal by the European Commission – which was thought to allow workers from other EU countries to be employed in France under their home legal conditions (and not French ones). These untrue assertions are puzzling and reveal a total lack of understanding of European rules[50].

Putting passions aside, we can try to take a closer look at the situation. The fact is that some legal guidelines do allow a Polish plumber to work in France without being subject to French standards. They apply to specific situations:

[48] The Polish plumber embodies the image of a migrant worker intending to work in France for a low salary without being subject to French labour or social security law. This mobility would be encouraged by the EU internal market which is regarded as responsible for the increase in social dumping within the EU.
[49] The combat against this text was led by French president Jacques Chirac.
[50] As well as they show the strong feeling of euro-scepticism among French population.

- a non-employed worker established in Poland can provide a temporary service in France, for example by working on a building construction site;
- an employed worker can be sent temporarily to France – "posted", in legal terms – by a Polish company which has concluded a commercial contract with a French company. For instance, the SNCF (the French public national railroad authority) could sign contracts with Polish companies allowing them to participate in the renovation of French train stations;
- a Polish worker may also be posted in France by a Polish employer which has contractual ties with a German company, which itself is a contractual partner to a French company. Chains of contracts and subcontracts are frequent in the industrial world and they can make it very difficult to control the correct application of laws (see infra). One can suspect that the complexity of these contract architectures is aimed at avoiding the application of national rules.

We will explain these models in detail later and also show how French law sometimes does not apply to some working situations which occur within its territory. Distinctions between legal and illegal situations are very narrow and EU law, as well as French law, tries to prevent fraudulent conduct by companies operating abroad. For example, it is quite easy to imagine a company established in France creating a company in Poland in order to post Polish employees in France who would be subject to Polish social legislation. This is actually a system which some major French companies in the sector of road transportation have been accused of developing. Reactions to such business models are also interesting to analyse and assess.

As regards Tunisian workers, the questions raised are basically the same: in essence, should French companies and French workers fear a "Tunisian Plumber"? In other words, is it legally possible for Tunisian workers, whether employed or non-employed, to work in France at Tunisian labor and social security standards, or at any other social standards lower than French ones? Can posting[51] be a model of economic development for Tunisian companies?

The point of this paper is to show that, although Tunisia cannot be compared to Poland (from a legal point of view) as it is not a member of the EU and, as such, is not subject to European legislation, there are possibilities for a Tunisian worker to be waived from French social legislation, allowing him (if he is self-employed) or the company he works for to cut costs. Economic competitiveness is indeed at the heart of the subject, as well as the confrontation between competition models and fundamental social rights.

6.1: Can a Tunisian worker working temporarily in France remain subject to Tunisian legislation?

[51] Posting, also called secondment, is a legal technique which allows an employed person to be sent temporarily abroad by his/her employer for a mission after which he/she will go back to his/her usual workplace. During the posting period, the worker remains subject to his usual workplace labour and social security legislation. He/she must remain under the authority of the employer who posted him/her. The accepted duration of posting is not clearly set. If conditions of posting are no longer met, the employee becomes subject to the labor and social security legislation of the current workplace. Posting may also apply to self-employed workers, who therefore can remain subject to their habitual workplace legislation while providing a temporary service in another country.

Cross-border posting of workers combines the application of two sets of legislation: commercial rules (contracts and subcontracts between companies) and social rules (legal status, concerning labor and social security). In a global market economy with highly efficient means of transportation and communication, posting of workers is nowadays a standard practice. For instance, since last summer the people of Orléans have been enjoying the newly-paved "rue de Bourgogne" where Italian artisans spent day and night completing the job (complying with core French labor rules?) after their employer won a European call for tender published by the city. They might just as well have been Tunisian workers. Two other examples: a Tunisian company may send ten of its employees to France to participate in the construction of a cruise ship at the "Chantiers de l'Atlantique" in Saint-Nazaire. This company is used to signing commercial contracts with foreign companies in order to squeeze construction costs by reducing labor costs[52]. Another situation, though surely less common: a Tunisian company may own a forest in France and could therefore send some of its own lumberjacks to cut the trees. Will French social rules be relevant in these cases?

If cross-border posting of workers inside the EU falls within the scope of Article 49 EC and directive 96/71 EC of 16 December 1996, posting of Tunisian workers to France is subject to International Private Law standards and to international bilateral agreements. These international standards describe which national legislation is applicable to migrant workers involved in a given case. As far as labor law is concerned (minimum wage, working time, security and safety, periods of leave, right to strike, types of working contracts, etc.), two sets of rule are of particular relevance.

6.1.1: Labor Rules

A) The GATS Rules[53]

Without restating the entire history of the GATT (General Agreement on Tariffs and Trade) and the GATS (General Agreement on Trade and Services), we can recall that, in terms of international law, it is a treaty which was signed and then ratified by the countries involved and which entered into force in January 1995. The GATS enumerates four modes of supply, one of which usually called "Mode 4", is of interest to the question at hand. Mode 4 requires the presence of a "natural person" (i.e., somebody) who covers services provided by a service supplier of one country in the territory of another country. The service must be temporary.

As this is a very sensitive subject among countries, especially because it interferes with the geo-strategic "North-South" vision, negotiations on the content of the agreement are still ongoing and many questions have been left unresolved or have received ambiguous answers. The GATS members have agreed on a list of sectors concerned by the agreement (e.g.: computers and related services, research and development services, telecommunication services, construction and related engineering services, etc.), but a

[52] See *Liaisons Sociales Europe*, 6 January 2005, issue n°119, p.2

[53] See A. Math and A. Spire, Vers une immigration permanente des travailleurs temporaires – du mode 4 de l'AGCS aux différents régimes migratoires de travailleurs détachés, IRES, document de travail n°04.06, June 2004 ; A. Math, L'envoi de migrants détachés dans le cadre de la libre prestation de services transfrontalières – quels risques pour les systèmes de protection sociale ?, *Revue de droit sanitaire et social* 2005 p.565.

central question is still unanswered: will the legislation of the host state apply totally, partially, or not at all to workers sent from one state to another in order to provide a service?

Some countries, mainly southern ones such as India[54], argue that liberalization should be complete and that workers should be subject only to the legislation of their habitual workplace. The USA seems to share this stance. The European Services Forum, which represents major European companies in the area of services[55], requires that salary conditions of the working country do not apply to contracts with a value in excess of 50,000 euros. The WTO also seems to support the application of the habitual workplace labor legislation. On the opposite side, the EU favours the application of core labor rules of the temporary workplace. This position is in keeping with the Convention of Rome principles (see below).

The discussions concerning the interpretation of the agreement are pointless, however, since the legal scope of the GATS is limited. Indeed, it has no "direct effect" within countries. This legal expression means that a person or a company cannot demand the application of a GATS provision before a national court, although international rules are supposed to prevail over domestic rules. GATS rules must therefore be transposed into national legislation to become fully applicable.

B) The Convention of Rome

The Convention of Rome on the law applicable to contractual obligations (19 June 1980) establishes uniform rules concerning the national law applicable to contractual obligations. As a system to resolve conflicts of laws, it does not set material rules which apply uniformly to international contracts, but designates which national legislation applies to the contract.

Hence, the Convention of Rome sets "rules of conflict" in the area of labor contracts. In the presence of a contract which could be covered by two or more national legislations because of its international context (for instance, workplaces in more than one country, place of residence in one country and workplace in another, etc.), the convention determines which legislation is competent so that both positive and negative conflicts can be avoided. As the convention is applicable within the territory of member states, notwithstanding the nationality of the person involved, it implies that Tunisian workers sent temporarily to France fall within its scope.

Two rules of conflict must be combined to understand which labor rules apply to a Tunisian worker temporarily employed in France:
1) The labor contract is governed by the law which the parties have chosen (very likely Tunisian legislation). If they haven't chosen a national legislation, the contract will be

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[54] India claims that none of the labour requirements of the host country applies and that social security contributions are waived by bilateral agreements.

[55] The European Services Forum is a network of representatives from the European services sector. It is committed to actively promoting the interests of the European services sector and the liberalisation of services markets throughout the world in connection with the GATS 2000 negotiations.

governed by the law of the country where the employer habitually carries out his work (Tunisia)[56].

2) Even if Tunisian legislation is applicable, allowance may be given to the mandatory rules (in French, "lois de police") of the legislation of another country with which the situation has a close connection. In our case, French legislation will be partially applicable since it is closely connected to the posted worker during his temporary stay in France[57].

The association agreement of 17 July 1995 between the EU and Tunisia also provides that Tunisian workers allowed to undertake paid employment in the territory of a Member state on a temporary basis shall be covered by the principle of non-discrimination with regard to working conditions and remuneration (art. 64 (2)).

This sophisticated system of resolution of conflicts of rules leads to the joint competence of French and Tunisian work-related law. One of the difficulties is to identify the "mandatory rules" that France is permitted to impose on Tunisian workers. The European Court of Justice of Luxembourg so far has not been asked to make a ruling on the definition of mandatory rules, although it now has the jurisdiction for the interpretation of the Convention of Rome. Therefore, it is national courts which are in charge of defining the content of mandatory rules[58]. One must notice that the concept may vary from one country to another, which is a source of confusion for foreign companies. This is why Directive 96/71 EC is so interesting, as it sets a common definition of "mandatory rules" throughout the EU[59]. Unfortunately, Directive 96/71 EC is not relevant for Franco-Tunisian exchanges as it applies only to companies established in EU Member states.

It is therefore necessary to take a look at the French labor code ("Code du travail") to determine which labor rules apply to a Tunisian worker temporarily employed in France. Indeed, not all French rules can be regarded as "mandatory rules" in the meaning of international law. The current French legal situation is confusing because two sets of rules coexist. A new law was passed in August 2005, designed to prevent foreign workers from being employed in France at lower standards than those of the Code du travail. The content of "mandatory rules" has expanded. This piece of legislation is actually an aftermath of the failure of the referendum on the European constitution and

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[56] Article 6 (*Individual employment contracts*) of Convention of Rome: "1. Notwithstanding the provisions of Article 3, in a contract of employment a choice of law made by the parties shall not have the result of depriving the employee of the protection afforded to him by the mandatory rules of the law which would be applicable under paragraph 2 in the absence of choice. 2. Notwithstanding the provisions of Article 4, a contract of employment shall, in the absence of choice in accordance with Article 3, be governed: (a) by the law of the country in which the employee habitually carries out his work in performance of the contract, even if he is temporarily employed in another country; or (b) if the employee does not habitually carry out his work in any one country, by the law of the country in which the place of business through which he was engaged is situated; unless it appears from the circumstances as a whole that the contract is more closely connected with another country, in which case the contract shall be governed by the law of that country".

[57] Article 7 (*Mandatory rules*) of Convention of Rome: "1. When applying under this Convention the law of a country, effect may be given to the mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract. In considering whether to give effect to these mandatory rules, regard shall be had to their nature and purpose and to the consequences of their application or non-application. 2. Nothing in this Convention shall restrict the application of the rules of the law of the forum in a situation where they are mandatory irrespective of the law otherwise applicable to the contract".

[58] National courts remain free to decide whether a case should be brought before the European Court of Justice. Parties are not entitled to bring directly a case before the European court.

[59] See *infra* n°27.

echoes the “Polish Plumber” fears. Although adoption of new legislation was considered urgent, no implementing governmental decree has been published so far. The new law which entered into effect on Jan. 1, 2007 remains hard to implement. It is also more protectionist. In other words, more French rules will be applicable to a Tunisian worker temporarily working in France, and potentially fraudulent situations are more closely examined.

According to article L342-1 of the Code du travail, companies established abroad and providing services through posting of workers must comply with French core rules, of legal and conventional origin:

- Individual and collective freedoms within the labor relationship, the right to strike, working time regulation, annual leave, weekly rest period and other periods of leave
- Minimum wage, including payment of overtime hours of work,
- Rules related to safety, health, security and medical protection,
- Rules related to non-discrimination based on gender, minimum age of work, night work, status of young workers

The reference to “Individual and collective freedoms within the labor relationship” in this listing must attract special notice. This expression is so general that it can cover a wide range of topics, in fact almost everything in the field of labor law, in contradiction with the concept of “mandatory rules”. This passage will certainly be subject to interpretation.

Concerning the combat against fraud, the 2005 law provides that rules on posting are not applicable if the employer activity takes place only in France. In such a situation, the entirety of French labor legislation becomes relevant. This provision indeed makes sense, but the challenge will be to ensure its effectiveness. As we will discuss later, one of the problems of the new legislation is the gap between theoretical measures of protection and their concrete implementation. Also, it is provided that French law is fully applicable if the activity is completed through infrastructures located in France, from which it is exercised with stability and continuity. The same impetus – the struggle against fraudulent posting – underlies this protectionist rule.

6.1.2: Social Security Rules

Rules regarding social security (in the traditional western European definition: retirement pension, invalidity pension, sickness, family, unemployment, death, survivorship, occupational disease and accidents at work) are highly important for employers as well as for workers. For employers, taxes are an element of the cost of work and therefore of the final price of goods or services sold; the lower taxes are, the more competitive the company will be. Determining applicable legislation is becoming a core element of cost-cutting strategy. For employees, the applicable legislation sets the level of social security rights, such as retirement pension or health coverage. The situation is complex, however, since the systematic application of legislation which is most favourable to posted employees may lead to undesired outcomes, given the fact that periods of work accomplished abroad may be very short. Hence, because a worker has worked only three months abroad for instance, this insufficient level of contribution may prevent him from being entitled to benefits. In addition, for benefits such as retirement or invalidity pensions, it will be more convenient to contribute to one single national pension scheme rather than two or more as it will be very difficult to claim rights in each country where a person has worked.

Regulation 1408/71 EEC sets precise rules of conflict which provide for the exclusive application of work legislation of the habitual state when a posting is expected not to exceed 12 months. If these rules cover migration of Tunisian workers between two EU member states[60], they do not apply to temporary professional migration between France and Tunisia.

The association agreement between the EU and Tunisia, which is another piece of EU legislation, seems to preserve the application of French legislation as workplace legislation: workers of Tunisian nationality "shall enjoy, in the field of social security, treatment free from any discrimination based on nationality relative to nationals of the member states in which they are employed" (art.65). This rule, however, aims to protect Tunisian workers who work permanently in France. It shall not apply to temporary work such as posting.

Therefore, it falls to the French legal system to determine whether its national social security rules are applicable or not. The principle is laid out in article L111-2-2 of social security code ("code de la sécurité sociale"). Also voted in August 2005, the law provides that any workers of whatever nationality, who work on French territory, whether permanently or temporarily, full-time or part-time, must be affiliated to the French social security scheme. This provision aims to ensure that taxes are levied on all professional activities which occur on French territory. Guided by the intention to combat fraud, the "lex loci laboris" principle, well-known in European social security schemes, takes into consideration the necessity to bring money into the coffers of national social security institutions. It also protects fair competition between foreign companies and those established in France, as well as ensuring that workers are granted an actual protection against social security risks.

Nevertheless, this principle remains in part theoretical. Its main goal is to reassure those who are worried that taxes may not be paid by firms who send workers to France. A more careful reading of the law shows that this goal will not be completely reached. Indeed, as the law states, it applies "notwithstanding exceptions contained in international agreements". The main exception concerns exchanges within the EU, as article 14 of Regulation 1408/71 (which is directly applicable in Member states and requires no transposition by national legislation) says that workers who are temporarily occupied in another Member state, whether employed or self-employed, shall remain subject to their habitual workplace legislation.

Regarding exchanges between France and Tunisia, regulation 1408/71 is not applicable, but roughly the same rule is stipulated in a bilateral social security convention signed by the two countries on 17 December 1965 and entered into force on 1 September 1966.

[60] See Regulation 859/2003 of 14 May 2003.

The convention provides that a Tunisian worker who is temporarily posted in France by a company established in Tunisia remains subject to Tunisian social security legislation, provided that all formalities are completed correctly (an administrative form, the content of which depends on the length of the posting, must be required and filled out before the posting). Article 3(2) a) of the bilateral convention states that a worker who is sent temporarily to France remains subject to his habitual workplace legislation provided that posting does not exceed three years or, exceptionally, six years in case of "unexpected circumstances"[61]. It clearly means that Tunisian workers employed in France shall pay their social contributions in Tunisia on the basis of Tunisian rates and legislation and that they will be entitled to benefits provided by Tunisian social security.

In conclusion, despite article L111-2-2 of the French social security code, Tunisian workers sent temporarily to France can legally avoid paying French social security taxes. This lawful situation generates a financial advantage for Tunisian companies which compete in the same markets as French firms.

6. 1.3: Preliminary Conclusions

As for labor rules, Tunisian rules will probably be applicable to a Tunisian worker habitually employed in Tunisia and sent temporarily to France. Nevertheless, core French rules will also apply simultaneously. The working conditions of the worker will then depend on the joint application of two national legislations. This situation may be very difficult to manage on a daily basis and is a source of potential misapplication.

Concerning social security rules, within the framework of the bilateral social security convention between France and Tunisia, only Tunisian standards apply. However, a different outcome would apply to other Mediterranean countries which haven't signed a bilateral social security agreement with France. Posted workers would be subject to French social security law, even if they remained subject to the legislation of their habitual workplace[62].

These conclusions demonstrate that the principle of territoriality, on which social law is founded and which is emphasised by the legislation of August 2005, is subject to important exceptions hidden behind (or above) the law.

From a Tunisian perspective, this does not imply, however, that the French market will be easily accessible to competitive Tunisian firms. Indeed, French authorities still have the power to control access to the national territory through two major requirements:

- Tunisian workers must be granted a work permit;
- They must hold a residence permit in order to be posted in France.

French legislation on immigration is generally strict, although surely more tolerant in regards to temporary professional activities. The association agreement between Tunisia and the EU indeed creates rights for Tunisian citizens in the field of social law, but it

[61] If conditions of article 3(2) a) are not met, posting is permitted, but the worker will be subject to French social security legislation (as well as, at the same time, Tunisian legislation).
[62] Two legislations might therefore become simultaneously applicable.

does not grant them the right to stay and work within the EU. This is clearly stated in the final act of the association agreement: “The granting, renewal or refusal of a residence permit shall be governed by the legislation of each member state and the bilateral agreements and conventions in force between Tunisia and the Member states”[63]. Except in specific cases which are not relevant to our study, the EU does not affect the right of member states to define their immigration policy concerning third-state nationals. The EU can be a source of rights, essentially based on the principle of non-discrimination on the grounds of nationality, but only Tunisian nationals who already legally reside in one of the EU member states benefit from this advantage.

6.2: Practical Issues

6.2.1: Easy ways to break the rules: a short guide

French legislation is designed to ensure that, at least regarding labor standards, Tunisian workers sent to France are protected by core French labor standards. Still, one can doubt that these fundamental national requirements are always respected. The French labor administration (“Inspection du travail”) lacks a sufficient number of inspectors and therefore is not able to maintain rigorous supervision. Without such inspection, one can well imagine that French core rules are not applied most of the time. Controls are made even more complicated by the fact that Tunisian workers are employed in France for a short period of time and they frequently change working sites. It may be hard to locate the employer or even to determine his or her identity. Language and cultural barriers make potential on-site inspections very difficult to perform. For instance, how can a French inspector ensure, on the basis of documents produced in a foreign language, that an employer is complying with rules about salary, working time, periods of leave, etc? How can it be possible for the URSSAF, the French administration in charge of recovering social security contributions, to check that contributions have actually been paid in Tunisia?

As for the distinction between permanent and temporary work in France, inspections are also very complicated for the above reasons. One can suspect that under the guise of posting, a Tunisian company may organize a turn over of its workers in order to maintain a permanent presence in France. The variety of working sites and the succession of commercial contracts as well as labor contracts will be a challenge for French inspectors. It will be hard for them to implement the relevant rules, although French law theoretically provides that when the activity of the employer takes place exclusively in France, French rules are applicable in their entirety.

It is true that the legal system of prior declaration should reduce opportunities to violate French law. The law indeed requires that local inspectors be informed of the posting and be provided information on the location of the activity, duration, working hours, housing,

[63] Also see ECJ *Savas*, 11 May 2000.

etc. However, even if the French legal system seems well-organised, we shall not be too optimistic about the way it is implemented.

Regarding work permit and residence permit requirements, it would be possible for Tunisian workers to arrive in France as tourists – as such, they are entitled to stay for a period of three months – and then work illegally. Not only would French core labor standards not apply to them under those circumstances, but they may not even be assured of being treated according to Tunisian standards, both for labor conditions and social security protection. Here, the problem goes beyond violation of rules on posting. It is a question of illegal work and the capacity of the French administration to fight this type of activity.

In many cases, the attitude of French companies seems to encourage infringement of the law. One interesting example concerns the "Chantiers de l'Atlantique"[64] in Saint-Nazaire, where around 800 subcontractors are involved. Alstom group decided some years ago to reduce the number of its own employees in order to replace them with workers employed by contractors and subcontractors settled in foreign countries. The goal was to lower production costs by reducing labor costs. Alstom has therefore substituted commercial relationships for labor relationships. The chain of commercial contracts including contractors (called "rank 1 partner") and several subcontractors enabled Alstom to consider that it was not responsible for potential violations of French labor standards and fundamental human rights of workers. Indeed, Alstom considers that it is obligated only to ensure the correct application of labor legislation by its "rank 1" contractors. For subcontractors, the task is supposed to fall to contractors. Although a so-called "Charter of social progress" was required to be signed by companies participating in construction of the ships, illegal practices still exist. Some workers must pay a lump sum for the right to be employed and their salaries, working, and living conditions are far below French standards. Inspections were carried out in February 2006 and 18 contractors from as many foreign countries were fined for various infractions such as the non-respect of minimum wage and maximum working time, or even performance of illegal work[65].

Another way to avoid the application of French labor standards is for a Tunisian company to recruit Tunisian workers who already hold the right to stay and work in France. In this way, the main obstacles to the process of "posting" are lifted. Tunisian workers concerned will indeed go back to Tunisia from time to time and will be "posted" in France, where the centre of their personal interests is still located. Only an in-depth inspection could reveal the situation to be illegal.

The legal system of posting obviously depends on an efficient cooperation between national administrations. Many questions can be posed: is the company that sends workers to France legally established in Tunisia? Does it have an actual business activity there or is it just a "mailbox company"? Does it comply with Tunisian rules on tax,

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[64] The « Chantiers de l'Atlantique » is one of the main shipyards in Europe located in St Nazaire, a city near Nantes. Until March 2006, it was the property of Alstom Group who sold 75% of the capital to a Norwegian group, Aker Yards.

[65] See *Libération*, 18 juillet 2006, Les soutiers des Chantiers de l'Atlantique. Another example: in December 2005, 21 Polish workers employed by a rank 1 contractor began a hunger strike, demanding to be paid at the French minimum wage standard, to be refunded the "recruitment tax" (3 to 5% of their salary), to be provided a work contract and wage slip, etc.

labor, and social security rules? From France, it is almost impossible to get reliable replies to these questions. If cooperation with Tunisian authorities does not work well, it means that Tunisian companies must be trusted on the basis of documents they produce.

6.2.2: Is it worth it for a Tunisian company to establish a subsidiary in an EU Member state and post workers in France?

Two reasons could justify such a business organisation: 1) avoiding the immigration barriers which make it quite difficult for a Tunisian worker to be allowed to stay and work in France, and 2) benefiting from the application of national legislation (of the place of establishment) which will be more flexible and less costly than French law. For instance, we could imagine a Tunisian company establishing a subsidiary in Portugal, where labor rules are less protective for workers and social security contributions are lower than in France. This company could then sign commercial contracts with French companies and temporarily send its own employees to France in order to do the work required by the contract.

Such a scheme is legal, provided that the immigration rules of the country of establishment are respected, that the subsidiary is legally created, and that it has an actual business activity in the country of establishment. If so, through Regulation 1408/71 (social security) and Directive 96/71 (labor), French social security and labor rules (except core labor rules[66]) will not be applicable to a worker posted in France by a Tunisian subsidiary installed in Portugal (or in any another EU Member state)[67].

If this arrangement can be profitable for a Tunisian company, what about its workers? Three situations can be analysed:

- If employees are EU nationals, they can cross borders inside the EU without restriction. No work permit or stay permit is needed. This principle also applies to nationals of the A8 Member states[68] since posting refers to free movement of

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[66] Article 3(1) of Directive 96/71: "Member States shall ensure that, whatever the law applicable to the employment relationship, the undertakings referred to in Article 1 (1) guarantee workers posted to their territory the terms and conditions of employment covering the following matters which, in the Member State where the work is carried out, are laid down:
- by law, regulation or administrative provision, and/or
- by collective agreements or arbitration awards which have been declared universally applicable within the meaning of paragraph 8, insofar as they concern the activities referred to in the Annex: (a) maximum work periods and minimum rest periods; (b) minimum paid annual holidays; (c) the minimum rates of pay, including overtime rates; this point does not apply to supplementary occupational retirement pension schemes; (d) the conditions of hiring-out of workers, in particular the supply of workers by temporary employment undertakings; (e) health, safety and hygiene at work; (f) protective measures with regard to the terms and conditions of employment of pregnant women or women who have recently given birth, of children and of young people; (g) equality of treatment between men and women and other provisions on non-discrimination".
Directive 96/71 has been transposed into French law by article L342-1 of the *Code du travail*, see supra n°13 and 14.

[67] Unfortunately, the definition of posting is not the same for Regulation 1408/71 and for Directive 96/71. If the first text provides that the "anticipated duration of the work does not exceed 12 months and who is not sent to replace another worker who has completed his term of posting" (article 14 (a)), Directive 96/71 defines a posted worker as "a worker who, *for a limited period*, carries out his work in the territory of a Member State other than the State in which he normally works" (article 2(1)). Another important difference is that the definition of employed worker is set by the home institution (Regulation 1408/71) and by the host institution (Directive 96/71) of the worker.

[68] The 10 Member states (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Slovakia) who joined the EU in May 2004 minus Cyprus and Malta (not subject to a transitory period).

services (no transitory period) and not to free movement of workers. For instance, a Tunisian company could establish a subsidiary in Portugal and quite easily send Polish plumbers temporarily to France. They would be subject to Portuguese social security law and both French and Portuguese labor law (if it is the national law which parties have agreed to apply to the contract).

- If employees are third-country nationals, already legally resident in the EU Member state where the Tunisian company has a subsidiary, workers posted in France (or in any other EU Member state) cannot be required to have a work permit since, according to ECJ rulings, posted workers do not have access to the local job market. This comes as a result of an important ECJ case[69], which applies to all intra-EU movement of services, regardless of the nationality of the workers. As for the residence permit, the Schengen area system allows foreign citizens to stay in France for up to three months if they arrive from another EU Member state in the Schengen area. For instance, a Moroccan national employed in Spain by a Tunisian company can be sent to France for a temporary period provided that he resides legally in Spain. For his period of work in France, he will be subject to Spanish social security law and both Spanish and French labor law.
- If the workers concerned are third-country nationals who intend to migrate and work within the EU area, the country of immigration could be chosen depending on immigration rules. If they have family members who legally reside in the EU, Directive 2003/86 of 22 September 2003 on the right to family reunification should help them get a residence permit more easily. For instance, if British immigration rules are favourable, a self-employed Tunisian national can migrate to the UK (perhaps through family reunification rules) and will have the right to be posted for up to three months in France and wherever in the EU for such short periods of work.

Conclusion

It appears that the system of cross-border posting is highly complex. There are many relevant legal instruments, both at national and international levels. At international levels, it is almost impossible to combine the sources which have different material and personal scopes: EU legislation, international private and public law, bilateral agreements at EU or national level, etc. The rules concerned cover several legal fields: labor law, social security law, immigration law, business law, etc. The fact that labor and social security do not follow the same pattern of rules is a supplementary source of confusion and administrative difficulties. It is hard to explain to a company and to workers that they are subject to rules from two different countries.

The fact that Tunisian workers can remain subject to their national social security law also shows that the risk of unfair competition between companies established in France and companies established in Tunisia is real. The lack of an efficient control structure of the French administration increases the risks of misapplication of French legislation. It is

[69] *Vander Elst* case, 9 August 1994.

also clear that it is possible for a Tunisian company to get into the European market (through a subsidiary) by "choosing" a favourable applicable legislation. However, national immigration rules should, to a certain extent, be able to prevent the development of posting of workers to France from Tunisia. It may not be good for international trade, but isn't it preferable for the sake of workers?

Finally, it is necessary to clarify the rules concerning cross-border posting of workers between EU countries and third countries. It requires defining the goals of these rules: should they encourage international trade? Should they protect developing countries? Should they protect fair trade? Should they protect the rights of workers? Once these questions are addressed, a coherent legal construction can be envisioned.

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