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Preamble

> *Respect for fundamental principles and rights at work are non-negotiable: not even in times of crisis when questions of fairness abound. This is particularly important in countries having to adopt austerity measures. We cannot use the crisis as an excuse to disregard internationally agreed labour standards.*[1]

On July 9, 2010, in a small province in the northeast of Panama called "Bocas del Toro", the conflict between the workers of the Trade Union Banana Industry and the National Police started. The workers were demanding the suspension of the new law No. 30, which eliminated the obligatory trade union contributions; it allowed only suspension of workers participating in the strike and hire of new workers; also, it allowed the police force to protect and safeguard the operation of business affected by the strike. The purpose of this new law was to follow the call of the Group of 20 and of international financial institutions for the liberalization of the labor regulation. Introducing of the law would lead to better investment opportunities. The actual president of Panama expected that with the relaxation of country's labor law the attractiveness of the country for foreign investments would increase and so will do its investment ranking, profiting the new government investment projects.

The conflict lasted for more than one week and left two casualties and hundreds of injured. After a week of violent public demonstrations, the conflict was over. The government agreed to suspend the law and started multilateral negotiations between different social and economical groups, with the purpose of elaboration a new law which would balance the interests of trade unions and the investment attractiveness of the country.

Panama is now facing one of the most important moments in its existence after the construction of the Panama Canal in 1914. With a GDP real growth rate of 10.6% in 2011, a deficit of 2.4%[2] and a decent sovereign rating, Panama appears

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[1] Juan Somovia, ILO Director-General's statement at The European Parliament (Strasbourg September 14, 2011)
[2] Global Finance, Panama country report (Retrieved from http://www.gfmag.com/gdp-data-country-reports/202-panama-gdp-country-report.html#axzz2S950gA71)

to offer very attractive investment opportunities. This year, foreign investment consisted of 948.4 million dollars spent on shares and other assets, as well as 873.8 million of reinvested earnings and 540.3 million from different capital incomes; remarking the balance achieved by the companies operating in the Panamanian free zone[3]. As it was analyzed in the “Informe Economico y social 2010” report made by the ministry of economics and finance, the investors in Panama are more willing to invest in public instruments like bonds with longer terms[4], and in this context government bonds look like one of the best options to invest.

Panama had a positive economic development due to favorable credit supply, according to country’s minister of finance[5]. Panamanian financial institutions had better financial capability compared with years before, the total amount of sovereign debt raised from the market this year was USD 958.1 million, almost the double that was raised in 2009[6] which increased the amount of money which was circulating in the country.

With important government projects, such as the expansion of the Panama Canal, construction of the first mass transportation system in the country, and the nationalization of all the highways, Panama’s ability to raise capital by external funding is becoming a top priority for the actual government.

Credit rating is known to be an important indicator of country’s attractiveness for investments. It acts as a signal for investors showing how favorable the conditions for investment in a specific country are, especially on its sovereign debt. Because of that, it is of interest for any country to have a good investment rating. Now that there are a number of government investment projects in Panama demanding considerable capital inflow, achievement of a good rating naturally becomes part of government’s scope of interests. For example, before Panama was awarded with investment grade, the Ministry of Economics and Finance (MEF) through the executive decree No. 97 organized a special commission (*Comisión para el logro del grado de inversión para la deuda de*

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[3] MEF, Direccion de Analisis Economico y Social, Informe Economico y Social (Panama: December 2010), p. 49
[4] Ibid. p. 39
[5] Ibid p. 41
[6] Ibid. 6

largo plazo de la republica – Comission for achieving an investment grade on a long-term debt of Panama Republic) designed to coordinate, advice and promote among the different ministries, bodies and departments of the country (including the Labor and Employment Ministry) the introduction of reforms or policies which would increase the sovereign debt rating and develop investment environment in the country[7].

Lately, credit rating agencies and variety of international bodies (European Community) and international financial institutions have been paying special attention to the state of the labor market in a country; the liberalization of labor market has been criticized for many years by international trade unions organization and especially in those countries where labor law is protective to trade unions. Extent to which labor law should be regulated is now subject to the global debate. The participation of these foreign institutions in the creation of national reforms is considered by many as interference in the national law creation process and sovereignty of countries. According to the World Bank's 2008 "Doing Business" publication, more flexible regulation is of importance for the attractiveness for investment and thus to jobs creation[8]. As Amin, 2003 research shows, more rigid labor laws in the Indian state of Maharashtra resulted in a decrease of 15% of employment[9]. Today, many countries, such as Singapore, New Zealand, United States, Hong Kong[10], are easing labor regulation and providing friendly environment for business. Other countries, such as Georgia and Denmark, even though considered to be in the top 10 countries with the most flexible regulation in the world, still have ratified all the international labor standards of the International Labor Organization[11]. These countries provide good protection to workers and at the same time offer very attractive investment conditions in terms of labor regulation. Further studies analyzing data from 90 developing countries (Lopez-Cordova, 2007, and Cunat and Melitz, 2007)[12] found out that exporting industries grow faster in the countries where labor regulation is flexible. Since exporting industries play

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[7] MEF, Decreto ejecutivo No. 97 §1, Gaceta Oficial Digital, (Panama: July 27, 2009)
[8] IBRD and The World Bank, Doing business 2008 (Washington, DC: September 26 2007) p.19. doi: 10.1596/978-0-8213-7231-9
[9] Ibid p.23
[10] Ibid p.4
[11] Ibid
[12] Ibid p.23

important role in Panama’s economy, we would expect the liberalization of the country’s labor law to have considerable impact on its economic growth. If we go back to our example with violent strikes in the export-oriented Panama’s Banana Company, we see that problem of weak regulation of trade unions is indeed acute in the country’s exporting industries. Labor law in the country confers excessive power on the trade unions, enough for them to affect the government decisions.

On the other hand, it’s important to note that economic progress doesn’t come always along with social progress and good living and working conditions. China, India and Pakistan, for example, have very flexible labor market and show considerable economic growth while having poor social conditions and living standards. The level of poverty and unemployment on these countries is alarming, and even in spite of the high growth rate, they haven’t been able to reduce or eliminate these social problems. The level of exploitation and abuse among the workers has been criticized also by many international labor institutions.

Moreover, several countries which used to have strong protective labor legislation (like Spain and Greece), due to their need to be more competitive and mitigate the effect of the financial crisis of 2007, have been introducing measures which are detrimental to collective working rights and trade unions. It has been almost 6 years since these countries started introducing changes to improve business competiveness and economic performance but until now, the government hasn’t been able to restore the balance.

Introduction

Our research focuses on the effect on the collective labor regulations produced by external institutions. First, we are going to describe how these institutions are functioning and through which mechanisms are they influencing the labor regulation in countries. To that end, we will present an analysis of practical examples like the labor reforms carried out in Spain and Greece during the recent economic crisis. We will discuss consequences of external influence on the trade unions' power, employment protection and employees' working conditions.

There are number of institutions affecting labor regulation in countries, and in our research we will distinguish two circles of these external influence agents. These circles have different mechanisms of influence, which will be described in due course. To the inner circle we attribute the European Union, which appear generally in collaboration with other institutions and organizations, such as the European Commission (EC), the European Central Bank (ECB), the International Monetary Fund (IMF), the Council of the European Union (CEU), the European Council (EurC). To the outer circle we refer the Credit Rating Agencies; we concentrate on the "Big Three": Standards & Poors, Moody's and Fitch.

Further, we will analyze collective labor reforms and discuss whether measures taken during the economic crisis created a race to the bottom of trade unions' and workers' rights. To conclude, we will explain the importance of the ratification of the International Labor Organizations (ILO) conventions and the adherence of collective labor rights in constitutional legislation.

Chapter 1. Credit Rating Agencies. Overview

History of credit rating started in the United States at the beginning of the 19th century. During the years 1817 to 1840, different US states started issuing sovereign bonds in the local and international markets in order to finance their projects, such as construction of canals, railroads, and variety of other infrastructure projects. As the country continued growing and urbanizing, local governments started to issue bonds. During these years, the United States was in desperate need for capital in order to exploit the country's resources and increase its growth rate.

Corporate debt issuance was used to finance most of the railroads in the United States. In the middle of the century, Railroad Corporations were small and located in populated areas. Most of them financed the construction by taking loans in the banks or by selling stock. Later on, as railroad corporations grew faster, they had to raise more capital in order to expand to the un-populated areas. But to raise more capital in the market was difficult at the moment because most of the investments were on rural territories and there were not enough banks and investors willing to invest.

This is when market development required transparency and information accessibility for attracting investors.

I. Standard's and Poor's

As we said, in this time it became crucial for the further market development that the essential information on companies would be available for investors. In 1860 Henry Varnum Poor published book *History of the Railroads and Canals of the United States*. This book contained a comprehensive account of the financial and operational information of U.S railroads. In 1868, Henry and his son organized the H.V and H.W. Poor Co. and published the *Manual of the railroad of the United States*. In 1873, Henry Varnum Poor retired but continued to edit his manuals. His son, Henry W, established an insurance brokerage and banking firm called Poor and Co. Meanwhile, Standard Statistics Bureau was founded by Luther Lee Blake (1906). It offered an accurate, centralized source of financial information for investors in the form of cards

which contained corporate news items. Later on, Standard Statistics merged with Poor in 1941 and from this, Standard & Poor's Corp was created.[13]

II. Moody's

In 1900, John Moody incorporated the John Moody & Company and issued the Moody's Manual of Industrial and Miscellaneous Securities. This manual provided data and statistics on bonds and stocks of different government agencies, financial institutions and different industries.[14]Despite this new innovation, the company couldn't survive the market crash of 1907.[15]After two years, John Moody founded Moody's and changed the main purpose of the business. Instead of collecting information, he started offering investors an analysis of security values and assigning letters depending on their assessment of risk. By doing this, he was the first to rate public market securities.[16]The company issued and published the book, "Analysis of Railroad Investments" which explains the analytical principles that his company used to assess a railroad's operation, management, and finance.[17]

In 1912, John Moody's also started evaluating industrial companies and utilities. Moody's Investors Service was incorporated on July 1, 1914 and started offering its services to US municipal bonds.[18]During the 1920's, the company covered nearly all of the US bond market. During the Great Depression, Moody's also continued offering its services and it was not until the 1970's that the company included commercial paper and bank deposit in their evaluation. It was also during this time that most of the major rating agencies started to charge the issuers and the investors for their ratings.[19]

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[13]S&P's, A History of Standards & Poor's. (11 February 2013) (Retrieved from: http://www.standardandpoors.com/about-sp/timeline/en/us/)
[14]Sinclair. Timothy J. (2005). The New Masters of Capital: American Bond Rating Agencies and the Politics of Creditworthiness. Ithaca, New York: Cornell University Press. ISBN 978-0-8014-7491-0.
[15]Moody's History" a Century of Market Leadership. (17 August 2011.)(Retrieved from http://www.moodys.com/Pages/atc001.aspx)
[16]Ibid. Sinclair. Timothy J. (2005). The New Masters of Capital
[17]White, Lawrence J. (Spring 2010) "The Credit Rating Agencies" Journal of Economic Perspective (American Economic Association) 24 (2).pp 211-226
[18]Moody's History" a Century of Market Leadership
[19]Ibid

III. Fitch

Fitch Publishing Company was founded on December 24, 1913 by John Knowles Fitch. At the beginning, the company started as a publisher of financial statistics, especially for the New York Stock Exchange. It used to provide critical financial statistics through the "Fitch Bond Book" and the "Fitch Stock and Bond Manual".

In 1924, Fitch started using, like S & P and Moody's, the letters rating scale to its reviews. It was not until 1975 that the three main credit rating agencies were recognized as Nationally Recognized Statistical Rating Organizations (NRSRO) by the Securities and Exchanges Commission. Nowadays, Fitch offers services in different areas, including the new area of structured finance, and, among other things, provides investors with analysis of complex financial products.

IV. Further development of Credit Rating Agencies

In 1934, the Security Exchange Commission was created. The Commission introduced a request for corporations to issue standardized financial statements. In 1936, an important change in Credit Rating Agencies was established: a decree pushed by bank regulators established a set of rules that prohibited banks from investing in "risky" or "speculative" securities. This reform encouraged banks to invest in safe bonds only, while whether the bonds were "safe" was determined by the manuals. At the same time the reform restricted the use of sources of information of their choice and obligated the banks to use "recognized rating manuals" such as Fitch, S&P and Moody's. This increased the recognition of these agencies and made other market participants pay attention to the reports of CRAs.[20]

Insurance Companies and pension funds followed the same path in the 1970's. They established minimum capital requirements that depended on the rating of the bonds that the company invested in. The outsourcing of judgment

[20] Lawrence J. White (2012), The Credit Rating Agencies: How Did We Get Here? Where Should We Go?, Antitrust Chronicle vol. 4 P.6, (Retrieved from: http://www.ftc.gov)

regarding the safety of bonds and the creditworthiness of the issuer virtually conferred the force of law on CRAs recommendations[21].

It was not until the 1970's that credit rating started to charge issuers for rating the debt. They understood that their evaluations were of great use for since they provide investors with comprehensive information and thus simplified for issuers raising capital in financial market. As their services became well known, more financial institutions requested a rating of their debt, which also made it easier for them to fulfill the capital and liquidity requirement established by the Securities and Exchange Commission (SEC). In 1975, the SEC centralized the Credit Rating, and other countries started incorporating ratings to their financial regulation. Capital accessibility was improved and costs of debt went lower.[22] Due to role of CRAs in the securities markets and the need to formally regulate and oversight rating agencies for biased behavior, the SEC formally recognized the CRAs. This recognition came through a "no action letter" sent by the SEC staff. Through this letter established that if a CRA or an investment bank or broker-dealer wanted to use rating for fulfilling regulatory requirements, the SEC had to approve the use of a rating of this CRA. The SEC would evaluate whether the rating by this particular CRA's rating was widely used and considered reliable and credible in the market. After the approval of the SEC staff, the letter was sent indicating the SEC's intention not start any action against this entity. Since then, several changes have been made to the criteria used by the SEC staff to evaluate the CRA.[23] Later on, the SEC named several CRAs as *Nationally Recognized Statistical Rating Organizations* (NRSRO) which meant that only the evaluations of these rating agencies were valid for the determination of Broker-Dealers' capital requirements and for other regulatory purposes. S&P and Moody's and Fitch were recognized as NRSROs from the start. Other financial regulators adopted the NRSRO category as well and limited the use of bond evaluations to those from NRSRO's agencies. In the next 25 years, only four additional firms were registered in the NRSRO but by the end of 2000, they were absorbed by the big firms, leaving the number of NRSRO's agencies to only three.[24]

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[21]Ibid
[22]Ibid. 12
[23]Ibid
[24]Ibid. 13

Today with the globalization of the markets, credit rating agencies play a more important role for investors. Their opinions and analysis can influence the demand and attractiveness of any debt or fixed-income security in the market. With the introduction of the Basel II in 2004, international regulators were also obligated to impose banks the use of credit ratings from certain external credit assessment institution.

The Credit Rating Reform Act was established on September 29 2006 and it required the US Securities and Exchange Commission to clarify how NRSRO are recognized. It also eliminated the "no action letter", changing the responsibility of granting recognition from the SEC staff to the SEC commission. Through this, the agencies had to agree to be regulated and over sought by the SEC. Not long after this, S&P filed unconstitutional complaints against this act, alleging that it was against the freedom of speech. During the summer of 2007, the SEC issued a regulation for the implementation of the act. It required CRA to issue policies to avoid misuse of non-public information, disclosure of conflicts of interest, and other policies seen as "unfair practice".[25]

Lately, CRAs have received an incredible amount of criticism from different financial experts. For example, many blamed CRA for the financial crisis 2007-2010, the economical crisis in Greece, and many other financial emergency events. Many experts suggest that among the factors that ignited the financial crisis were: the failure of the CRAs to accurately price the risk of the mortgage asset back securities; government's lack of willingness to reform CRAs' regulatory practices; and influenced by CRAs the lack of confidence over countries' sovereign debt.[26]As it was mentioned in the Levin–Coburn Report, "*the crisis was not a natural disaster, but the result of high risk, complex financial products; undisclosed conflicts of interest; and the failure of regulators, the credit rating agencies, and the market itself to rein in the excesses of Wall*

[25]Lawrence J. White (2009), A Brief History of Credit Rating Agencies, How financial Regulation Entrenched this Industry's Role in the Subprime Mortgage Debacle of 2007-2008, Mercatus on Policy No. 59, P.2, (Retrieved from: http://mercatus.org)

[26] Marc Blanco Reniu, Austerity Measures in the Current European Debt Crisis What drives governments to choose these unpopular policies?, Master Thesis, Avialable from University of Tokyo (Retrived from: http://www.pp.u-tokyo.ac.jp/courses/2012/documents/5140143_7b.pdf) P. 4

Street."[27] Today, CRA requirements like objectivity, independence, and transparency are being reviewed and their influence and role in the financial market is being studied by scholars around the world.

Moreover, the G20 are also analyzing reforms to the international banking regulation. The banking restrictions on their ability to hold certain types and amounts of risk are getting even stricter after the financial crisis. For example, pension funds are encouraged by law to diversify risk at extreme levels, making for them very problematic to manage risky assets. Morgan Stanley's "*Research Europe September 27, 2010 Report for wholesale banks"* shows that the Basel 2.5 and 3 are expected to increase the Risk Weight Average's (RWA) by a 24% for wholesale banks on a look through basis on 2012, making it very costly to hold risky instruments in their portfolios.[28]

The strategies of today's banks are changing, adapting and improving their ability to satisfy the minimum capital requirement and the cushion buffers that the new national laws and international standards are imposing. The Basel 2.5 and 3 introduce the "Incremental Risk Charge" which takes into consideration credit risk migration into the assessment of the risk of trading assets.[29] The actual VaR-based methodology does not take into consideration any downgrading of credit instruments; this is expected to increase the RWA to a double, making trading at margin very costly. Now, this feature puts a burden on the issuers to take care about maintaining the stability of credit ratings of its instruments, to provide high liquidity on its assets, and to maintain low its cost of capital. These changes in the international financial regulations produce an incentive in countries that considerably depend on debt to put attention towards sovereign credit rating.

With the unavoidable influence that CRA exerts in the international markets, governments are thinking about changing the role and rules in which CRA operates. Some governments have analyzed about applying legal limitation and

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[27]United States Senate Permanent Subcommittee on investigations (13 April, 2011), Wall Street and The Financial Crisis: Anatomy of a Financial Collaps, Majority and Minority Staff Report, Pp 1, Washington DC
[28]Morgan Stanley (2010), Morgan Stanley Research Europe, Wholesale banks Basel 3 at Glance-How the bank stack up Pp, 1-2 (Retrieved from: http://www.morganstanley.com)
[29]Ibid. 15

criminal and civil liabilities to the agencies. Others are suggesting starting their own domestic rating agencies with different regulatory restrictions. Even now, with Greece's credit crisis, different organizations, especially the European Union that has strongly disagreed with CRA's reports and findings, is considering to create a European CRA in order to avoid the main CRAs' influence and further financial crisis[30].

Although several countries and international organizations have expressed their disagreements with the credit rating agencies, most of them have pushed other countries during the crisis to introduce structural and regulatory changes that are recommended and proposed by the CRA. The EU in order to restore the financial stability of both countries has set up as one of its main goals the necessity of getting back the attention of the investors in those countries which have problem to raise capital with sustainable conditions in the market. And one of the methods to achieve this goal is to comply with the credit rating agencies' recommendations, which reflect investors' interests. It is for this reason that the EU has conditioned their financial support "the Bailout Deal" to the introduction of regulatory and structural reforms at national levels. The truth is that no matter what changes and reforms will be implemented in the international financial regulation, CRA will always play an important role in the financial market.

[30]Nikki Tait (April 29, 2010), Europe- Rethink on rating agencies urged, Financial Times (Retrieved from: http://www.ft.com)

Chapter 2. Methodologies used by the credit rating agencies and their influence on labor regulation

Credit rating agencies play an important role in country's ability and costs of issuing debt ever since the agencies started assigning rates to sovereign government debt.

The World Bank in the communiqué published on April 27, 2009 requested its staff to stop using the labor indicators in "Doing Business" flagship publication. Before that, the report used to give higher rating to countries with the weaker workers protection. This decision comes from the Word Bank's interest in social welfare and conditions. CRAs, on the contrary, have no interest in social situation, taking, however, labor regulation and workers employment protection into consideration when evaluating sovereign and private debt.[31] This is especially true regarding trade unions regulation. CRAs assign inferior ratings to the sovereign debt of the countries where labor regulation is permissible and favorable to trade unions, allowing their active participation in the political system. In order to prove this point, we will explain the CRAs' methodology for evaluating sovereign debt in this chapter. [32]

In order to evaluate the risk of default of a government's debt, analysts consider various characteristics of a country's economy; for example, Moody's rates sovereign bonds by dividing relevant factors into four main groups: an institutional profile, an economic profile, government financial strength, and susceptibility to event risk.[33] The first two factors are the ones incorporating labor regulation and trade unions position.

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[31] The World Bank (October 7, 2009) Guidance Note for World Bank Group Staff on the Use of the Doing Business Employing Workers Indicator for Policy Advice, Washington Dc: Doing Business P. 1 (Retrieved from: http://www.doingbusiness.org)

[32]Dieter Kerwer (2004), Holding Global Regulators Accountable-The Case of Credit Rating Agencies, Governance, Vol. No. 18 (3), P.21 DOI: 10.1111/j.1468-0491.2005.00284.x

[33] Pierre C., Guido C., Kristin L., Thomas B., Dietmar H., Aurelien M. (2008) Moodys, Sovereign Bond Ratings Moody's Gobal Sovereign, (Report Number: 109490) (September 2008) Pp. 2-9 (Retrieved from http://www.moodys.com)