Trade, Process Innovation and the Bargaining Power of Unions

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Extended Abstract

There are two important features influencing the investment decision of firms: first, globalisation has become an important factor in the behaviour of firms. Firms that operate on an international market take this into account when making their investment decision. Recently a literature is emerging, stressing the role of trade costs in international trade, for example, the containerisation or advances in communication technology has reduced the costs of delivering a good or service abroad. Second, unions are a major source of influence in the economy and firms have to take into account the union behaviour when making strategic investment decisions.

In this paper we tie up both ends and study the investment choice of firms in an international market in the presence of unions. We show that, depending on the distribution of the bargaining weight between a firm and the union, a fall in trade costs has a positive or negative impact on investment.

In this paper we develop a two country duopoly model. Firms sell in their domestic markets and are able to export, incurring an additional trade cost. Additionally, firms are able to invest in new a technology, which increases their productivity. To produce output, a firm has to go to the labour market and hire workers. We assume that the respective domestic labour market is imperfect and the firm has to negotiate with a union.

The thought experiment in the paper is a fall in the trade costs. As stressed above we have a situation in mind where the transport costs fall (or tariffs are reduced). We show that the
distribution of the bargaining weight between the firm and the union is the important determinant for the response of the investment. Specifically, we show that if firm has more bargaining power, trade liberalisation has a positive effect on investment, whereas, if the union has more bargaining power trade liberalisation has a negative impact on investment.

We analyse several extensions to the paper. First, we analyse the case of imperfect labour markets in one country only. Second, we allow investment by one firm only. We show that in both case trade liberalisation always has a positive impact on investment. Third, we plan to analyse the welfare impact of trade liberalisation in our model.

This paper departs from the literature on investment, unions and trade by assuming trade costs. Trade costs are an important part of international trade, which we argued above. To our knowledge, the literature on trade, unions and investment has not addressed this issue so far. The paper contributes to the literature on investment and union in a context of international trade. It advances the literature by showing that there is a link between the investment behaviour of firms and the distribution of the bargaining weight.