Evaluating Labour Market Reforms: Policy Choice, Relevance, and Evidence of Results

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Outline of the presentation

- G20 labour market reform agenda
- What do we know about impacts? The case of employment protection law (EPL)
- Challenges in measuring institutions in developing countries
- Avoiding a fragmented approach to labour markets
1. G20 labour market reform agenda

G20 reform agenda is based in a large part on G20MOD, which in its turn is strongly influenced by the OECD Going for Growth Methodology.
Evidence: a snapshot

- The OECD Going for Growth Methodology choice of reform measures (type and direction), however, is not entirely consistent with the existing empirical evidence; the inconsistency being mitigated by the country-tailored actual policy advice.

- This leads to inconsistencies between the empirical evidence, the advice that countries receive through the OECD Going for Growth Methodology, and the G20MOD underlying the “extra 2%” goal.

- Moreover, reliable estimates from empirical studies are often unavailable for developing and emerging economies, or in a post-2008 setting.
2. Expected impacts? Example of EPL

- One of the most controversial labour market institutions
  - Theory: costs of firing modify incentives to hire. Thus, EPL affects employment flows, while stocks are “relatively” unchanged.
  - Empirics: over two hundred studies to date, showing negligible aggregate effects in both directions (if any), depending on the set-up. Certain consensus: groups at the “margins” of the labour market are affected the most.
The World Bank and the ILO agree on the existence of the “plateau” effects: the relationships between strictness of EPL and aggregate employment is non-linear.

Source: Cazes et al., 2012; World Bank, 2013
EPL: Some of the most recent “consensus” views on income and productivity effects

- ILO research also shows a non-linear relationship between EPL and private business investment: only particularly strict regulations have negative effect; in all other cases the relationship is null or slightly positive.

- IMF (WEO, 2015) also shows that “labor market regulation is not found to have statistically significant effects on total factor productivity”, in an analysis based on 16 G-20 countries.

Source: Cazes et al., 2012
Level of Employment Protection in G-20 Countries, 2010

Source: ILO, 2015
3. Challenges in measuring institutions

Level, Coverage, Compliance: An analytic framework
Legal Coverage of Employment Protection Legislation, 2010

Source: ILO, 2015b
Compliance with Employment Protection Legislation

No systematic data, but examples of approaching the issue:

- Survey questions on the receipt of severance pay by eligible workers
- Labour inspections statistics
- Court statistics on labour disputes (percent of cases brought to courts, percent of winning)
Coverage and compliance: Example of Indonesia

- Labour force: 100%
  - Of which, legally covered by EPL: ~34%
  - Of which, in complying firms: ~30%
  - Of which, eligible to severance: ~20%

R = Relevance of the system:
Employees who received severance pay as proportion of all eligible: ~30%
Employees who received severance pay as proportion of all separations: 6%

** Ratio of actual amount received to legally entitled severance pay: :~38.5%

Source: ILO, 2015; Brusentsev et al., 2012; World Bank Enterprises Survey, 2015
Does it make sense to look only at levels of regulations, and to forecast effects of the changes in levels, if we do not account for coverage and compliance?

Compliance may be endogenous: how do we strike the right balance between the level and the compliance? However, compliance is a function of the level of regulations, but not exclusively, as witnessed by examples from the both ends of "levels".

Should not the "right" question be the improvement of the relevance of the institutions, rather than uniquely of the level of protection that they offer?

- Recent AER (Meghir et al., 2015) evidence on Brazil: improving compliance by raising enforcement clearly leads to improved welfare without negative impacts on employment.
Labour Market Institutions

- Labour taxes
- EPL
- UB
- ALMPs
- Child care
4. Avoiding a Fragmented Approach to Labour Markets
Example of Minimum Wage coverage

![Chart showing minimum wage coverage in various countries in mid-2000's and late 2000's.]

Source: Belser and Rani, 2015, in Berg, 2015
Estimated rate of compliance with minimum wage legislation in selected developing economies

Source: Belser and Rani, 2015, in Berg, 2015
Example of Collective Bargaining coverage

The weighted average for the EU is 58%

Source: ILO, 2015c
Also, a balanced approach which considers demand-side effects

- A wide range of labour market institutions (e.g., minimum wages, collective bargaining, social protection) have significant positive effects on aggregate demand and economic growth.

- The tendency of declining labour income share (driven by widening gaps between wages and labour productivity) and widening inequality.

- These are known to be associated with the weakening of labour market institutions (IMF, 2015, Berg, 2015).

- It is important to consider the risk that G20 labour market reform agenda may worsen demand deficits in some countries.
Final remarks

- The need of certain reforms in certain countries is not denied.

- Rethinking institutions: shifting the debate from levels of regulations to a reform strategy that can improve the functioning of institutions.

- Institutions should be correctors of market failures.

- Country-specific tailored approach is needed, taking into account the complexity of the institutional system.

- A more balanced policy package is needed to address both aggregate demand and growth potential.
Thank You

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References