

Labor Market Regulation and Good Practices



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Outline of presentation

1. *Defining labor market regulation*
2. *Regulators of labor markets*
3. *Economic purposes of labor market regulation*
4. *Economic effects of labor market regulations*
5. *Different models of labor market regulations*



Long definition:


Labor market regulations range from how employers contract for the services of labor to the nature of the exchange – including the rights and responsibilities of the parties, the terms and conditions of work, and the resolution of disputes.

Short definition:

Restrictions to the formal freedom of contract between employers and workers.

Three common areas of labor market regulations:

1. Regulation of market entry
2. Regulation of market exit
3. Regulation of conditions in employment contracts



Regulation of market entry

- *Restrictions to child labor*
- *Restrictions to labor immigration*
- *Regulation of vocational training*
- *Regulation of entry to specific professions*

Regulation of market entry

- *Retirement age and pension system*
- *Early retirement*

Regulation concerning employment contracts

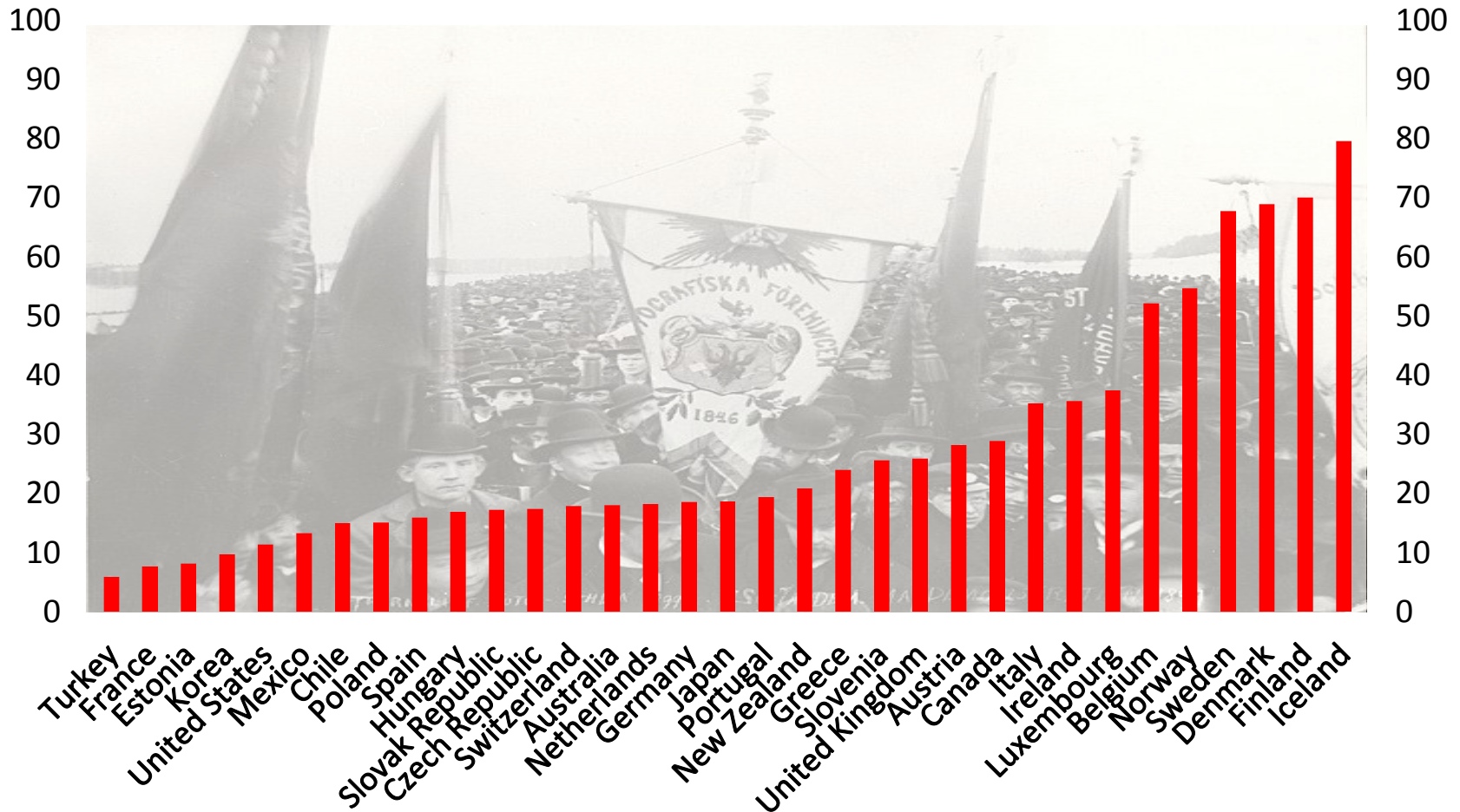
- Working time (e.g. maximum hours/week)
- Wages (e.g. minimum and overtime wages)
- Sick pay and sick leave
- Holidays
- Inclusion in social security system
- Employment protection

Regulators of the labor market

- *The state (national and local governments)*
 - *regulates labor and social legislation*
- *Social partners (trade unions and employers' organizations)*
 - *in charge of collective bargaining and collective agreements*

Large differences in union density

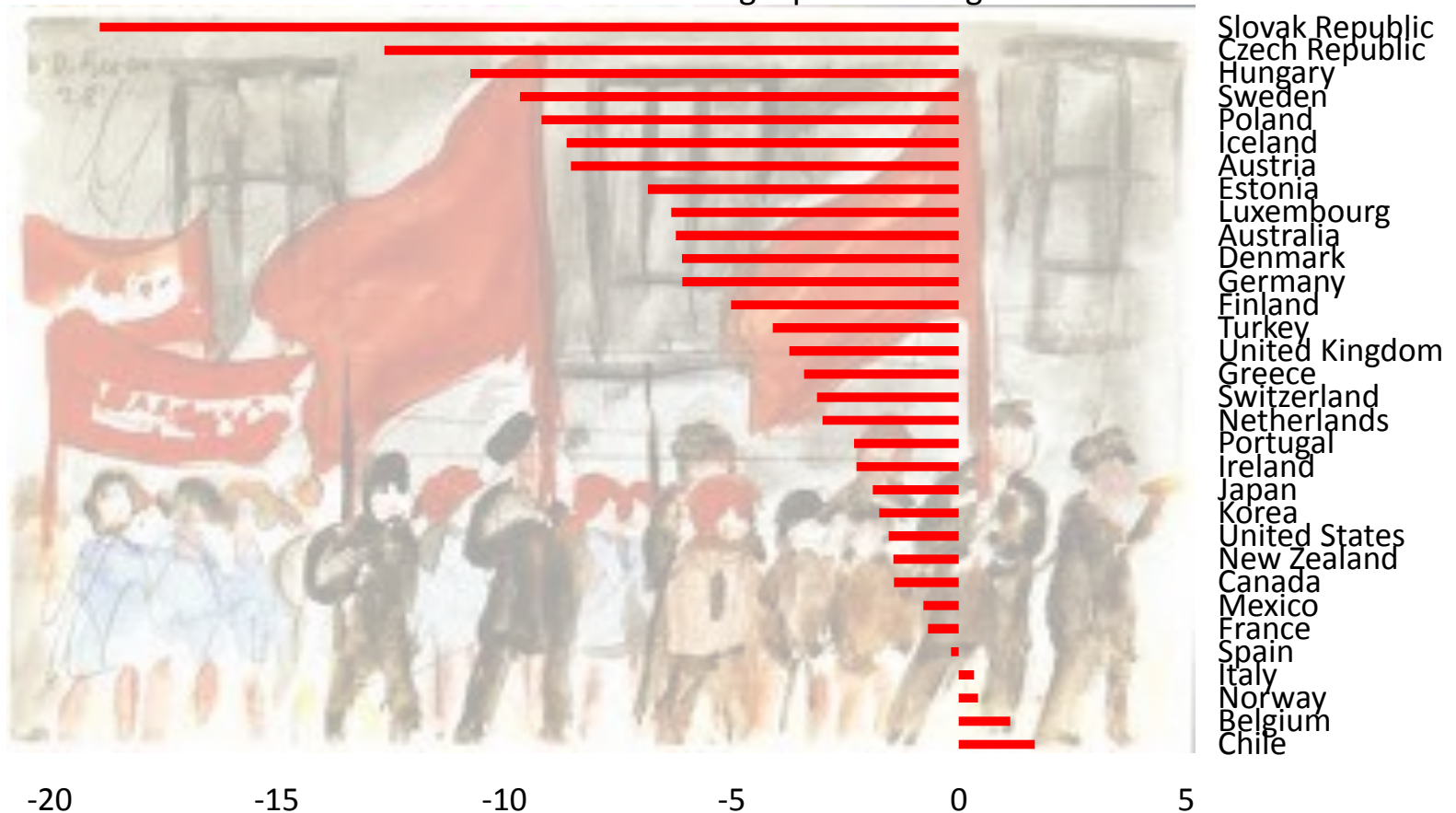
Trade Union Density in OECD, circa 2011
Percentage of employees



Source: OECD Employment Outlook 2012

Global downward trend in union density

Change in union density during the last decade, OECD countries
Percentage -points change



Source: OECD Employment Outlook 2012

Economic purposes of labor market regulations

Government intervention due to so-called market failures:

- *Imperfect information – creation of market transparency*
- *Imperfect competition – protection of employees in markets characterized by unequal bargaining power*
- *High transaction costs – reduction of bargaining costs and risk of conflict between employees and firms*

What is more common – market failures...



... or government failures?

Economic costs of labor market regulations

Government intervention creates distortions in the labor market:

- Prevents wages from equaling their marginal product in equilibrium, resulting in a misallocation of resources
- Hinders the adjustment of labor markets to economic shocks
- Redistributes economic rents from capital to labor, resulting in a reduced profitability of investment

What does the research say?

Two areas that have been thoroughly investigated:

- *Minimum wage legislation*



- *Employment protection legislation*



Negative employment effects of minimum wages

“[T]he studies surveyed in this monograph correspond to 102 entries in our summary tables. Of these, nearly two-thirds give a relatively consistent indication of negative employment effects of minimum wages, while only eight give a relatively consistent indication of positive employment effects.”

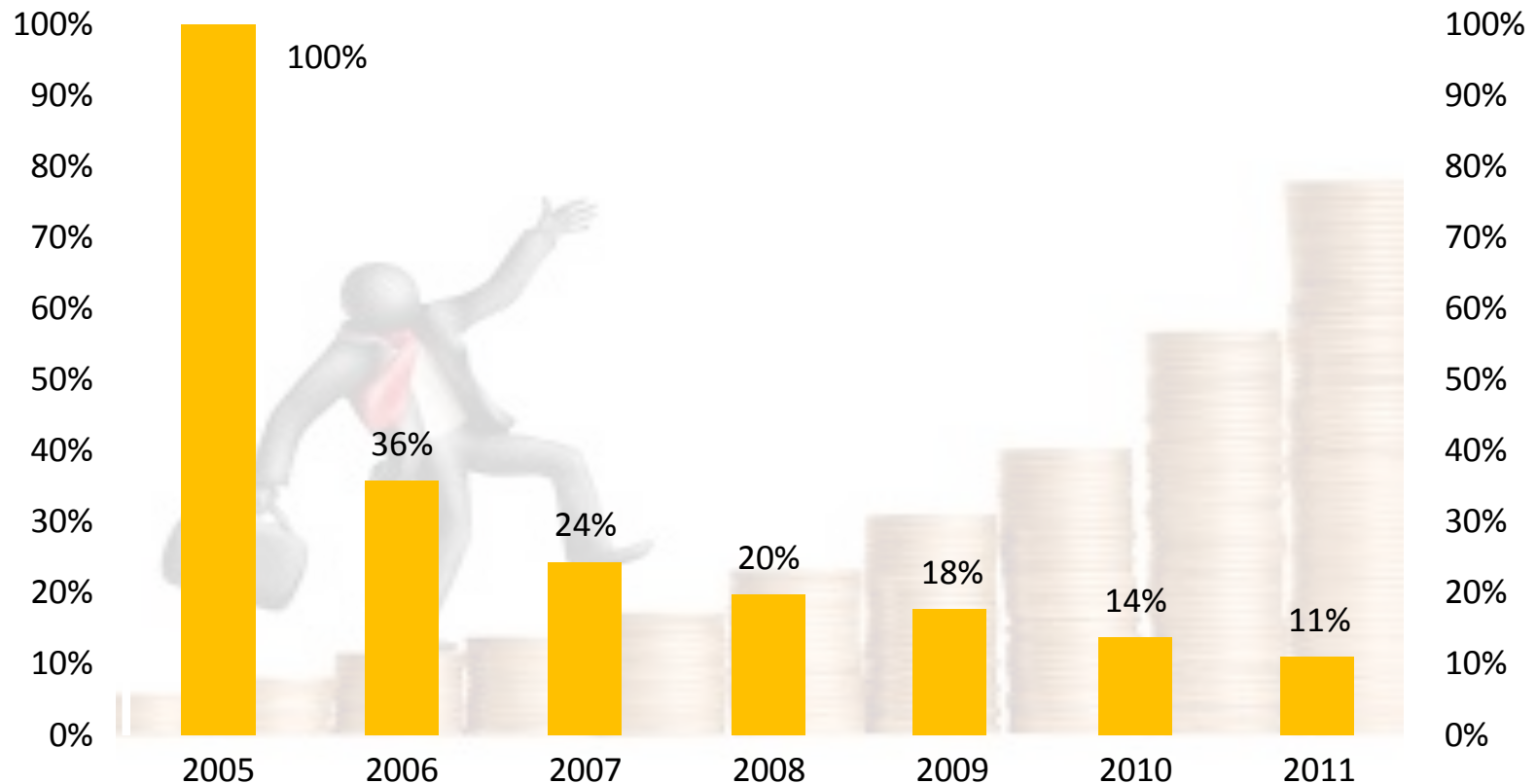
“Moreover, when researchers focus on the least-skilled groups most likely to be adversely affected by minimum wages, the evidence for disemployment effects seems especially strong.”

Source: Neumark and Wascher (2007). “Minimum Wages and Employment”. Foundations and Trends in Microeconomics. Vol. 3. No 1–2.

Wage dynamics more important than minimum wages

Share of employees who are stuck at the lowest wage decile in Sweden

Percentage of employees who belonged to the lowest wage decile in 2005



Source: Confederation of Swedish Enterprise

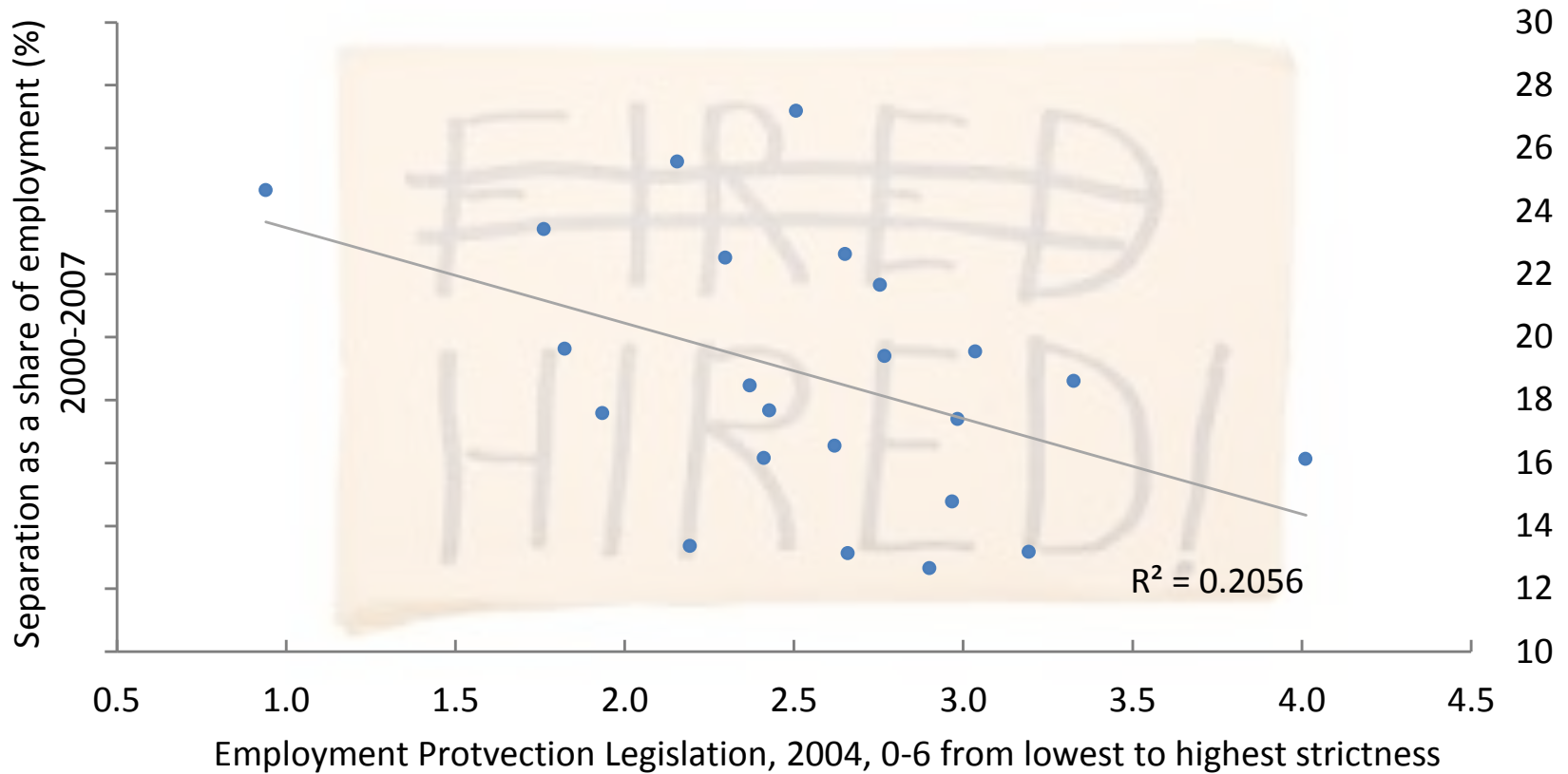
Negative effects of employment protection

- Higher levels of informal employment
- Higher unemployment among youth, women, and immigrants (insiders vs outsiders)
- Slower labor market adjustment after economic shocks
- Slower employment and productivity growth

Source: Angel-Urdinola and Kuddo (2010). “Key Characteristics of Employment Regulation in the Middle East and North Africa”. World Bank.

Weak employment protection tends to increase separations

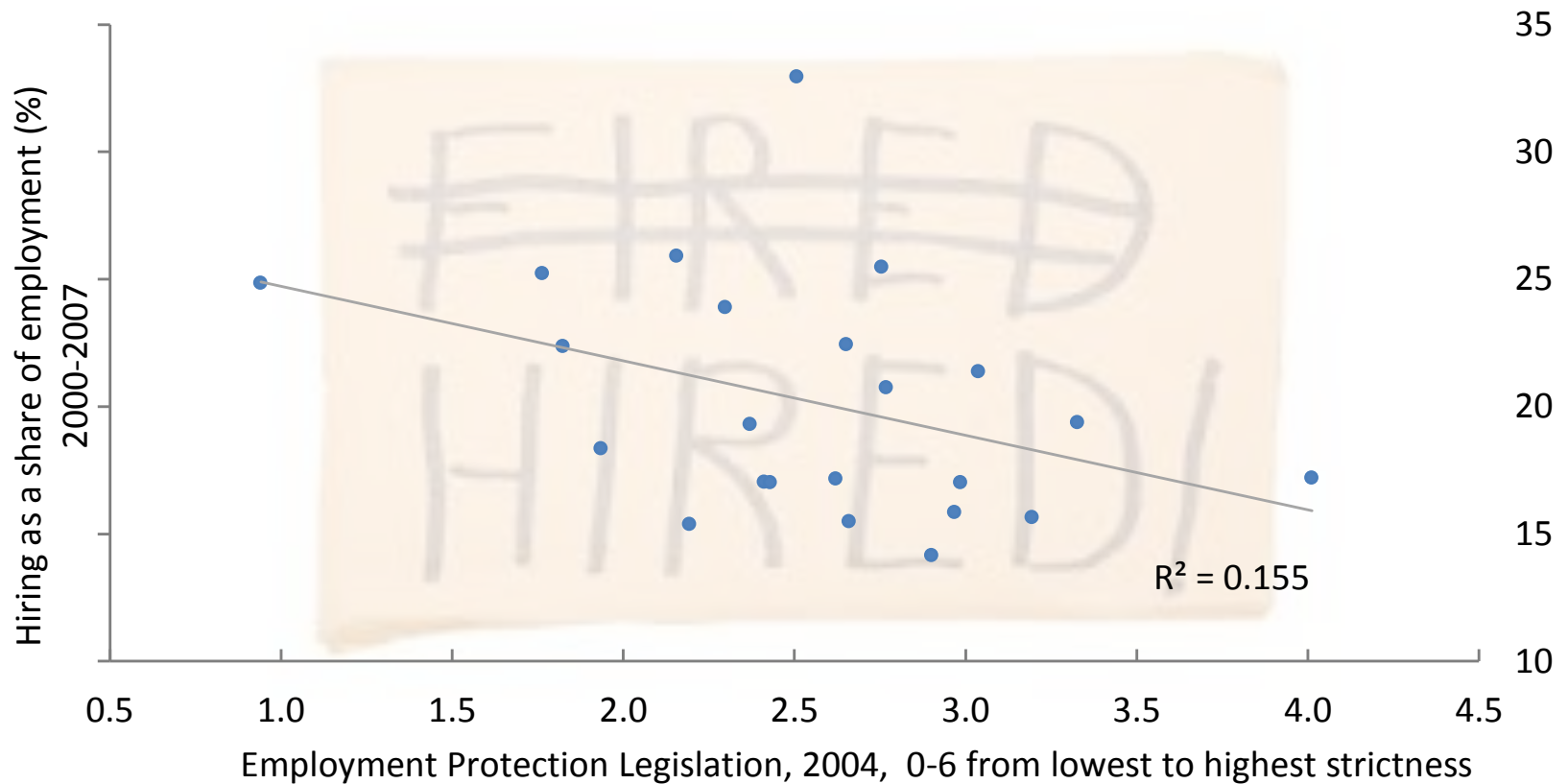
Separation and Employment Protection in OECD countries
Mid 2000's



Källa: OECD and author's own calculations

More importantly, though, it also tends to increase hiring

Hiring and Employment Protection in OECD countries
Mid 2000's



Källa: OECD and author's own calculations

Employment restrictions negatively affects job creation

Net employment effects of abolished firing/hiring restrictions in Egypt



Source: Angel-Urdinola et al (2010)

Three labor market models: Sweden

- Relatively strict firing restrictions (first in, last out)
- Generous out-of-work benefits (70-80% of previous salary for up to 300 days)
- High, but decreasing, trade union density (70%)
- Very high collective bargaining coverage (90%)
- High de-facto minimum wages (79% of mean wage in the service sector)

Three labor market models: Denmark

- Not very strict firing restrictions
- Generous out-of-work benefits (50-90% of previous salary for up to two years)
- High, but decreasing, trade union density (67%)
- High collective bargaining coverage (65%)
- High de-facto minimum wages (71% of mean wages in the service sector)

Three labor market models: USA

- No strict firing restrictions
- Relatively low out-of-work benefits (~45% of previous salary for 26 weeks*)
- Low trade union density (11%)
- Low collective bargaining coverage (13%)
- Relatively low minimum wages (37% of mean wages in the service sector)

*temporarily increased

Three labor market models

	Employment protection	Out-of-work benefits	Union density
Sweden	Relatively strict	Generous	High
Denmark	Not very strict	Generous	High
USA	Not strict	Relatively low	Low

Three labor market models: outcomes

	Worker reallocation*	Immigrant/native unemployment**		Productivity level***
Sweden	19%	2.7	(=16.0/6.0)	\$52/hour
Denmark	26%	2.1	(=14.5/6.9)	\$53/hour
USA	25%	1.1	(=7.5/6.8)	\$60/hour

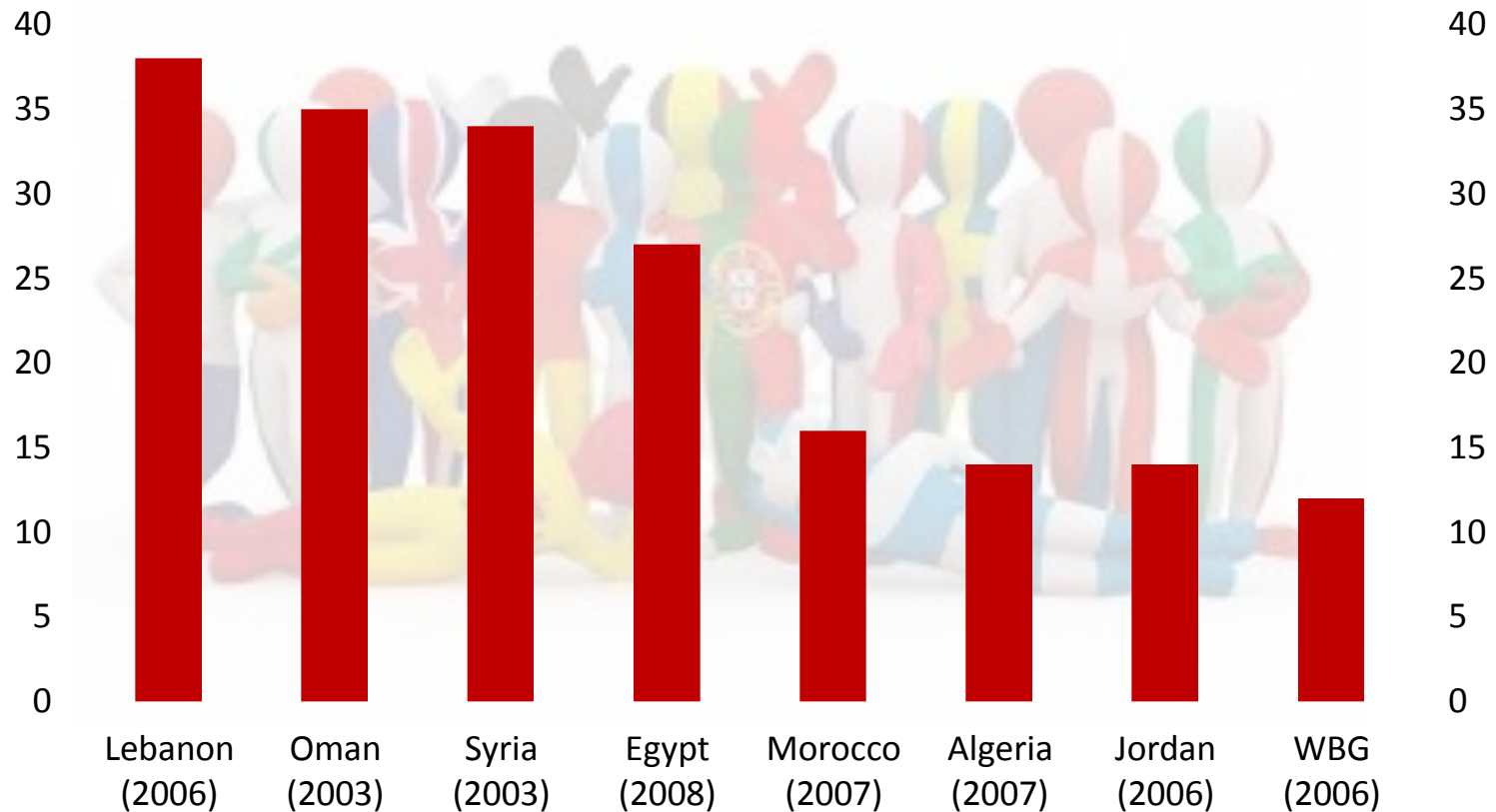
*Average of hiring and separations as a share of total employment, 2000-2007

**Relationship between unemployment among foreign-born and native-born, 2011

***Purchasing power adjusted productivity level, 2011

Strict labor market regulations – a global problem

Share of Firms Identifying Labor Regulations as a Major Constraint to Doing Business (percent of total)



Source: World Bank 2010 at: www.enterprisesurveys.org

The political dilemma of labor market regulations

- * Politicians and strong lobbying groups tend to either
 - ignore the negative effects of strict labor market regulations or
 - argue that there is a trade-off between economic efficiency and equity
- * The losers of strict labor market regulations tend to be:
 - young, poor, low-skilled, lacking labor market experience
 - small businesses with no lobbying experience
 - and
 - unorganized

The political dilemma of labor market regulations

"Those who are willing to surrender their freedom for security have always demanded that if they give up their full freedom it should also be taken from those not prepared to do so."

Friedrich August von Hayek (1899-1992)

Nobel Laureate of Economic Sciences 1974

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