



# Regulatory and Labor Market Policy Reforms: What is Feasible?

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## **Some issues for discussion**

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# Four points

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- But before two caveats:
  - Difficult to generalize about LM policy and institutions given the huge heterogeneity and interactions
  - (Teal) the creation of more and better jobs depends on many factors outside the labor market
- 1. Micro data suggest large dynamism in the LM, with many jobs created and destroyed and large workers' mobility
- 2. The LM regulatory framework: (beyond fundamental workers' rights) de jure regulations tend to be relatively strict, but seldom enforced
- 3. The LM policy framework: income and other forms of support for the unemployed are limited
- 4. We should understand the political economy of the status quo and of reforms

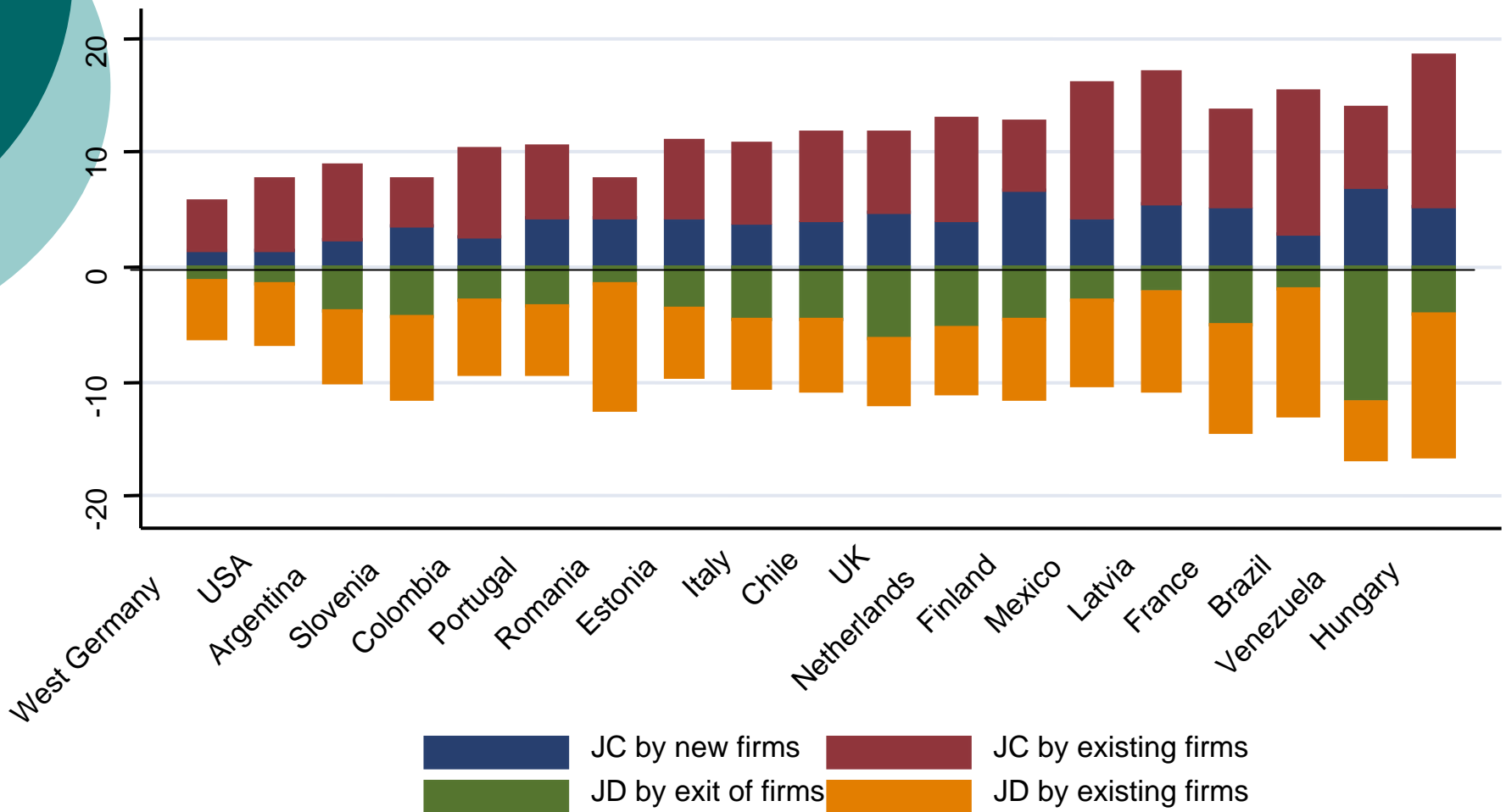
# Market economies require continuous reallocation of labor

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- Enterprise data suggest sizeable job flows (20 OECD – 30 LAC, ECA)
- Because of sizeable entry and exit of firms (15-20%) involving 8-10% of employment (Foster *et al.* 2002; Bartelsman *et al.* 2004)
- Because of continuous process of adaptation of existing businesses to changes in market conditions and dev. In processes and products.
- Reallocation important for productivity growth, but under conditions: painful to workers and ineffective if regulations in different market distort flows.

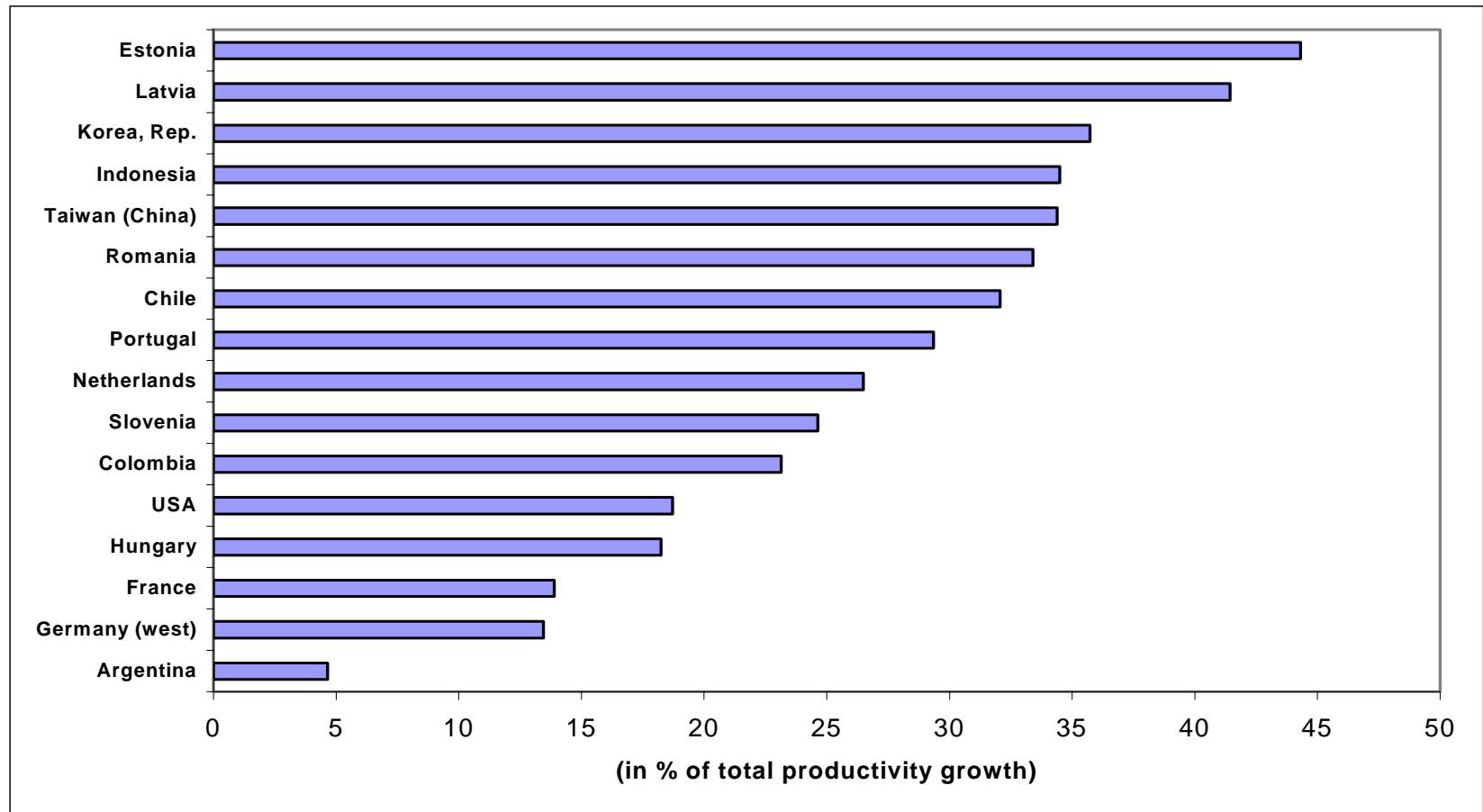
# All countries experience large job creation and job destruction

Manufacturing, annual job flows, 1988-2000



# Labor reallocation is important for productivity growth

(contribution of entry and exit to labor productivity)



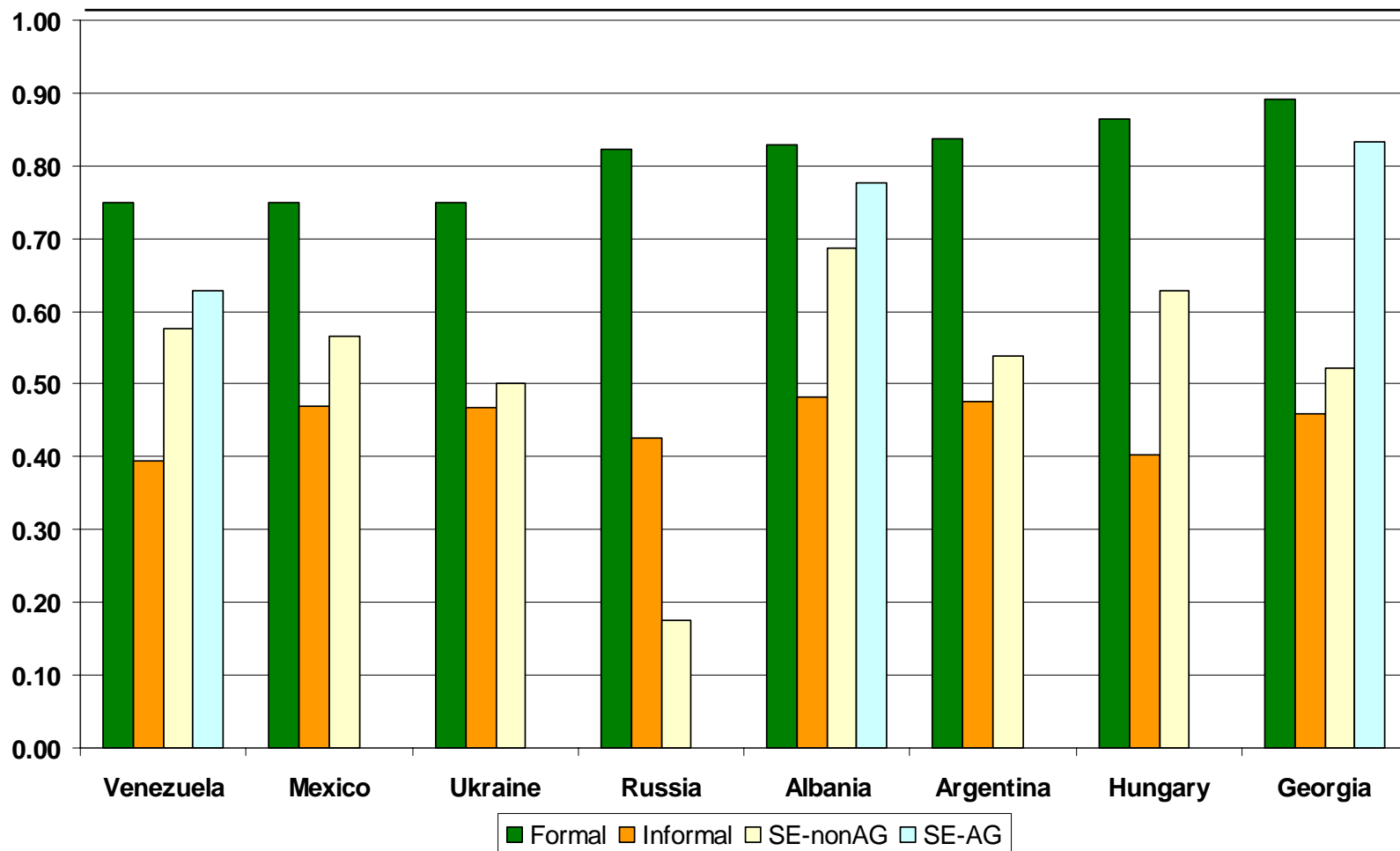
Source: Bartelsman, Haltiwanger and Scarpetta (2004).

# Larger mobility in developing countries

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- **Larger proportion of small firms and unskilled labor-intensive activities.**
- **Larger and frequent macroeconomic shocks**
- **But also because sizeable informal sector, where jobs tend to be more unstable**
- **Bottom line: we should look a dynamics in the labor market from both the firm perspective (job flows) and workers' perspective (workers' mobility using longitudinal H surveys)**

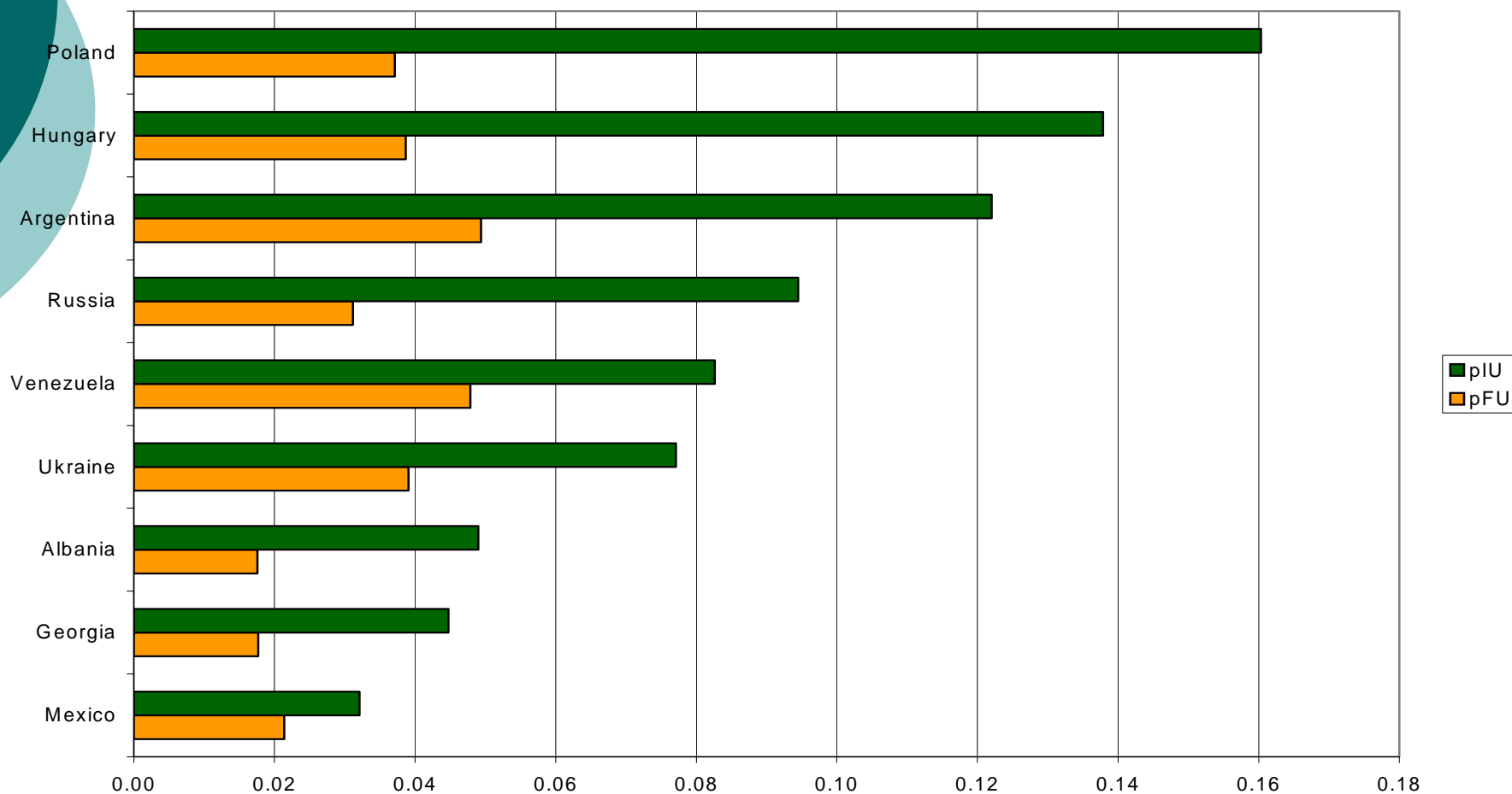
## Persistence in the different labor market sectors: informal more precarious



Source: Duryea et al (2006)

# The probability of entering into unemployment is higher for informal than for formal workers

Probability of entering into unemployment



Source: Duryea et al (2006)



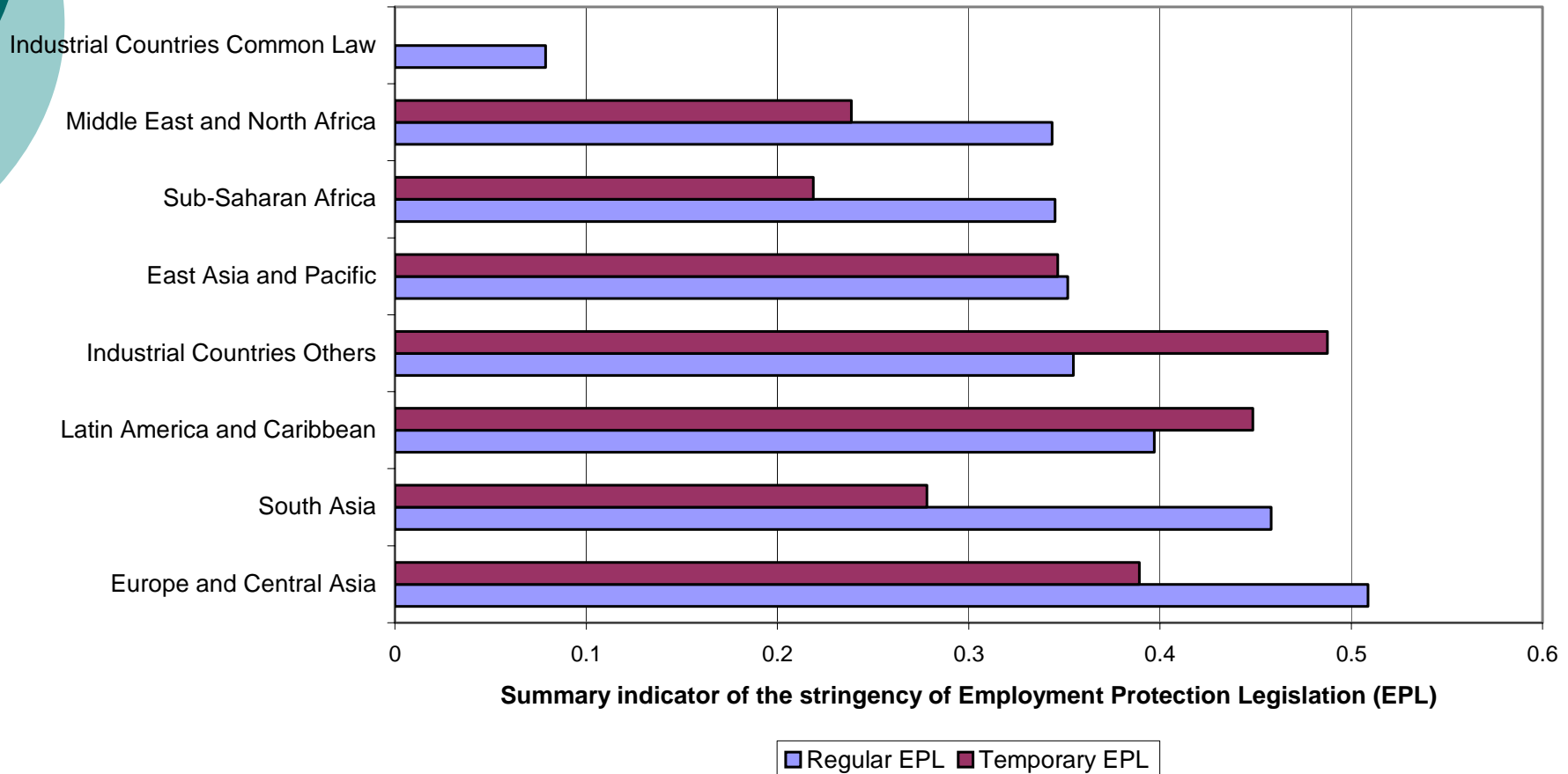
# Protecting jobs, high *de jure* protection – but low *de facto* protection

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- We now have synthetic indicators of *de jure* labor regulations for many countries (working time, hiring and firing, etc.)
  - They suggest that low income countries tend to regulate the LM more than middle income and industrial countries
- But surveys to firms often suggest that employers do not consider LM regulations as the most important constraints
  - Why: low enforcement even among formal firms
  - But if we go a step ahead and try to understand for which firms LM are a problem we discover that are not the very small nor the very big but generally medium-sized firms, innovative firms
- The question is: Are LM regulations -- that are strict on paper but seldom enforced -- an issue that is worth addressing, also given the high political capital involved in any labor reforms?
- The answer could be yes, to the extent these regulations discourage firm expansion, investment in technology and ultimately the creation of more and better jobs

# Protecting jobs, high *de jure* protection – but low *de facto* protection

Level of employment protection by region

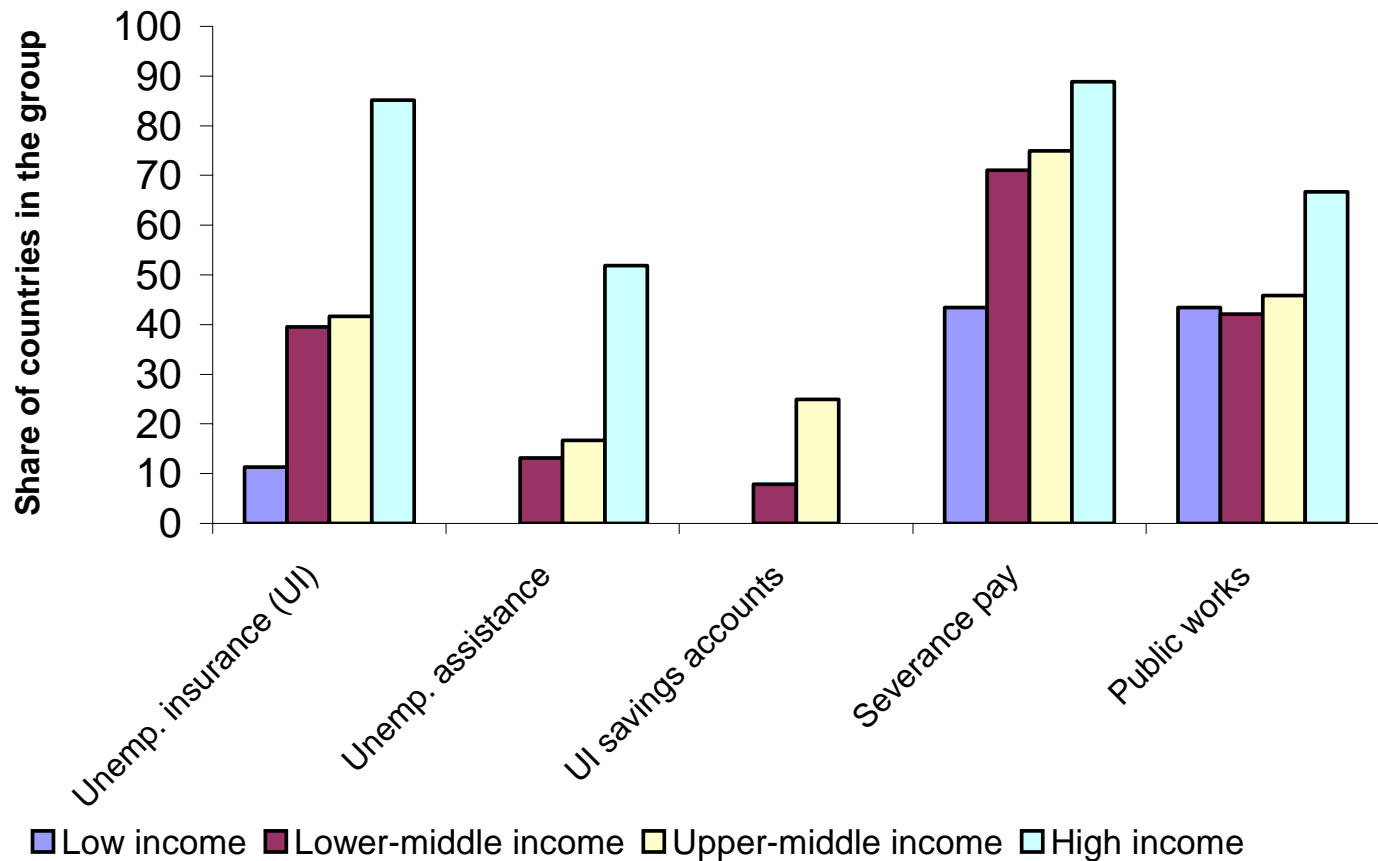


# Protecting workers: limited support largely relying on severance pay

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- We cannot look at LM regulations in isolation: we have to consider also the other pillar of LM intervention: active and passive LM policies
- Income support for the unemployed – limited and available only to formal sector workers
  - Relies in general on severance pay – do not pool unemployment risk; unreliable as they depend on the financial conditions of the firms
- Active labor market programs:
  - training and retraining open to the unemployed (generally not the most vulnerable groups)
  - Limited experience on job counselling.
  - Limited experience on programs that target disadvantaged groups in the rural or informal sector. Some interesting experience of workfare programs.

# Protecting workers: limited support largely relying on severance pay



# Shifting protection from jobs to workers: is it feasible?

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- Status quo of high *de jure* protection of jobs and little support to the unemployed
  - Does not necessarily reduce flows in the labor market but distort them, with negative effects on allocation of resources
  - Greater dualism (formal/informal, small/large firms, skilled/un-skilled)
- Fragmented and ineffective labor market policies
  - Large informal sector implies many workers not protected by EPL
  - Even for formal sector workers have to rely on severance pay which are often not available (e.g. when firms are in financial troubles)
- **What is feasible:**
  - **Weak administrative capacity and limited resources → EPL may be the only way (e.g. Blanchard, 2002 EPL as proto-insurance)**
  - **In countries with some administrative capacity, shifts from EPL to income support (individual savings accounts)**
  - **But the issue remains of how to protect informal workers. U assistance and/or workfare programs?**

# We need more empirical evidence to guide policy

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- Cross-country time series analyzes:
  - Several studies for OECD countries, less for developing countries
  - Measurement issues and omitted variable problems coupled with limited time series
- Difference-in-difference cross country sectoral studies:
  - Available data for growing # of countries (e.g. Micco, Pages, 2005; Haltiwanger, Scarpetta Schweiger, 2006)
- Micro/sectoral country studies
  - Exploit episodes of reforms (Kugler, 1999; Hopenhayn, 2004; Saavedra, 2003)
  - Exploit cross sectoral (e.g. Terrell, 2004) or cross-state variations (e.g. Besley & Burgess, 2004 Lemos, 2005, Almeida, Carneiro, 2006)
  - More micro data available (firm-level individual-level) allow to look at job creation/destruction, labor mobility
  - More panel data (Fields)