Multi-year Expert Meeting on

ENHANCING THE ENABLING ECONOMIC ENVIRONMENT AT ALL LEVELS IN SUPPORT OF INCLUSIVE AND SUSTAINABLE DEVELOPMENT, AND THE PROMOTION OF ECONOMIC INTEGRATION AND COOPERATION

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Labour Institutions and Development under Globalization

by

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Labor Institutions and Development: Friends not Foes

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Main Narrative: two-pronged

1. Strong labor Institutions are bad for competitiveness;
2. Lower competitiveness means lower growth;

J. Buchanan:

"Just as no physicist would claim that water runs uphill, no self-respecting economist would claim that increases in the minimum wage increase employment."

Thus: A <u>luxury</u> developing countries cannot afford

Custodians of the Narrative

- WB 2008: "… laws created to help workers often hurt them"
- WB 2019: cut minimum wages, facilitate dismissals and remove other labor regulations to favor employment and economic development
- IMF (Loungani and Duval, forthcoming): "generous" unemployment insurance instead of other protections;

The Trouble with the Narrative

- Data don’t confirm the negative impact of labor regulation;
- Development strategy implied by main model (export-led-growth) is not sustainable globally;
- Measuring overall level of regulation is complex.

Another Model, Another Narrative

- For Late-industrializers growth is typically constrained by the BoP:
  - long-term output growth constrained by export growth;
  - Developing countries cannot permanently run and finance a trade deficit.

Another Model, Another Narrative

Assume:

	Depend on:
Exports	World Income, based on technological diversification
Imports	Domestic Income
	Relative Prices
GDP Growth	Growth of world income
	Growth of capital inflows
	Growth of unit labor cost
	Exchange rate appreciation/depreciation
Constraint/Closure	Imports = exports + capital inflow

Observation: Stronger labor institutions drive up wages;
Question: What happens to growth?

What Happens to Growth

- Effect is an empirical matter (Marshall-Lerner condition);
- Evidence on ML is mixed. We assume weakly satisfied.
- Effect of higher wages on growth and employment is null or positive
- If ML is strictly satisfied, effect would be negative: small effect because wages are only a fraction of output price;
- BUT…

There are two more effects

- Labor productivity growth: higher wage drives higher productivity offsetting effect on ULC

- Industrial upgrading: higher wages drive less efficient firms out of business. The others diversify and upgrade. Exports become more responsive to world income.

Summarizing

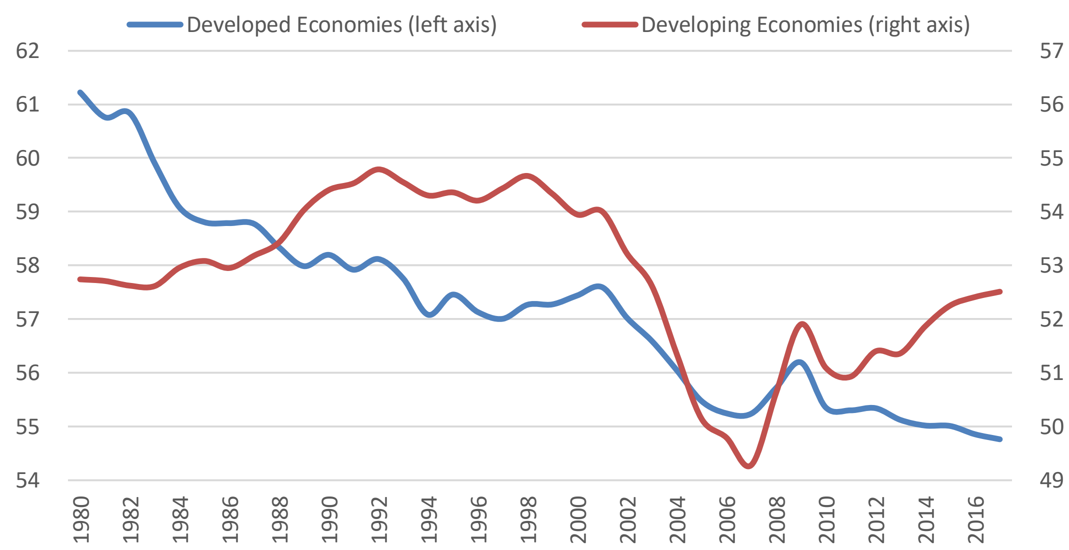
- Three effects:
  - <u>Loss of competitiveness</u>. If ML is satisfied, BoP constraint tightens and growth decelerates;
  - <u>Faster productivity</u>. It improves competitiveness;
  - <u>Upgraded composition of exports</u>. One-time increase in world income elasticity of export demand and permanently higher growth.

There's More: Political Economy

- Effects of stronger labor institutions:
  - Higher Legitimacy of Industrial Relations (Weberian Effect)
  - Spur to Innovation (technology-forcing, Schumpeterian Effect)
  - Higher Labor Share, leading to stronger domestic demand, a key driver of dynamic efficiency (better division of labor, learning by doing and more – Keynesian-Kaldorian Effect).

Oh, the labor share…

Labor share (percentage of GDP): 1980-2017



Notes: Labour share is calculated as ratio of the sum of compensation of employees and mixed income to GDP; developing countries do not include economies in transition. *Source*: United Nations Global Policy Model.

Doubt and the True Luxury

- The “pratical” question:

  All this may be true and the model may be fine but in the end we have to advise on policy;

- Answer:

  The model is a logic for the times when data don’t help. The standard models says “when in doubt curb LM institutions”. The alternative model says “when in doubt, make them stronger”

- For developing countries the true luxury is NOT having strong labor market institutions.

Thank You

References:

- Storm, S. and J. Capaldo, 2018, “Labor Institutions and Development Under Globalization”, *INET Working Paper No. 76*

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