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Designing Labor Market Institutions in Emerging Market and Developing Economies: Evidence and Policy Options

Prepared by Romain Duval and Prakash Loungani[1]

Authorized for distribution by Maurice Obstfeld

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Authors' E-mail Address: RDuval@imf.org; PLoungani@imf.org

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EXECUTIVE SUMMARY

As they try to close gaps in living standards with advanced economies, emerging market and developing economies face the challenge of providing greater social protection to workers while preserving economic efficiency and growth. Building sound labor market institutions is a key part of this agenda. It is also a challenging one; the need for such institutions and the risks of policy failure are both greater in emerging market and developing economies than in advanced economies.

This note reviews the state of theory and evidence on the design of labor market institutions in a developing economy context and then reviews its consistency with actual labor market advice in a selected set of emerging and developing economies. The focus is mainly on three broad sets of institutions that matter for both workers' protection and labor market efficiency: (1) employment protection, (2) unemployment insurance and social assistance, (3) minimum wages and collective bargaining. Text mining techniques are used to identify IMF recommendations in these areas in Article IV Reports for 30 emerging and frontier economies over 2005–16. Keeping in mind that IMF recommendations are shaped not only by efficiency and equity objectives (the focus of this note) but also by political economy, technical capacity, and fiscal sustainability constraints, the main findings are as follows:

- Overall, advice has been broadly consistent with the available consensus on how to foster flexibility while strengthening safety nets; for example, in advocating reliance on worker rather than job protection. The advice has evolved along with the increasing emphasis on the need for more inclusive growth.

- At the same time, scope remains for better integrating efficiency and equity considerations, accounting for interactions between different policy areas, and considering more specific policies in each area.

- On unemployment insurance, the advice has focused primarily on strengthening social safety nets. In the future, greater attention could be paid to the design features of unemployment insurance systems; how they could be scaled up over time; and the need to complement them with well-designed tax systems, active labor market policies, and broader policies to curb informality.

- On employment protection, while advice to ease legislation in many countries is broadly consistent with existing evidence, the focus has often been on reducing severance pay. Reducing uncertainty about the cost and duration of firing procedures might be more important. In the future, the policy stance in this area could be linked to the buildup of unemployment insurance—as the latter is put in place, employment protection could be scaled back.

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- On minimum wages, growing attention has recently been paid to reducing inequality, which is a welcome development. When advocating the scaling down of minimum wages for efficiency reasons, governments and advisors could more systematically provide alternative options—such as cash transfers or income tax credits—to meet their equity goals.

- On collective bargaining, different (more or less centralized) systems can in principle achieve efficiency and equity, so analysis should focus on the detailed features needed for a given system to deliver, for example, the required degree of representativeness, coordination, and trust between bargaining parties.

INTRODUCTION

1. The overarching goal of labor market policies and institutions is to deliver high and stable employment and productivity (*efficiency*) while providing adequate protection to workers (*equity*). The goal is easy to state but difficult to fulfill; this is true in advanced economies and even more so in emerging market and developing economies. Efficiency needs still loom large in emerging market and developing economies as they try to close the income gap with advanced economies. At the same time, workers in these economies, particularly lower-income workers, often lack basic protections, so considerations of equity cannot easily be set aside on the path to more efficiency. What is known about the optimal design of labor market institutions and policies in emerging market and developing economies? And what advice have these countries received from the IMF on these issues?

2. To shed some light on these questions, the analysis in this note proceeds in two steps. First, based on our reading of the theoretical and empirical literature, general policy lessons are drawn about how to (re)design labor market institutions in emerging market and developing economies, focusing on issues of greatest relevance to the more advanced among them: emerging market and frontier economies. The note examines the details of each institution, the interactions among them, and the need to adjust them over time as the country develops. Second, it identifies IMF recommendations to 30 emerging market and frontier economies on labor market policies over the period 2005–16. These recommendations are then benchmarked against the general lessons from the literature review. The structure of the note is thus comparable to Blanchard, Jaumotte, and Loungani (2013), who carried out a similar exercise for advanced economies.

3. The focus is on three broad sets of institutions that matter for both workers' protection and labor market efficiency: (1) employment protection legislation (EPL), (2) unemployment insurance (UI) and social assistance, and (3) minimum wages and collective bargaining. These institutions interact with other labor market policies such as labor taxation and active labor market policies, which are also touched on. This note does not cover social welfare systems in general (for example, pension or health), whose design raises a host of issues that go beyond the scope of this paper.

4. For advanced economies, Blanchard and others (2013) discuss how these institutions can be designed to provide the flexibility—micro and macro—needed for efficiency while also keeping

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equity in mind. For *microflexibility* (the economy's ability to carry out the reallocation of workers to jobs needed for productivity growth), the key institutions are UI and EPL, which countries combine in different ways. The Nordic combination of moderate employment protection and high unemployment benefits (*flexicurity*), but with strong active labor market policies (*activation policies*) to get the unemployed back into work, is a beacon for many countries. For *macroflexibility* (the ability to maintain employment at a high level, particularly in the face of large economic shocks such as loss of competitiveness or major recessions), the critical institutions are minimum wages and collective bargaining. Minimum wages obviously serve a distributional purpose but they can have adverse effects on efficiency, particularly on the employment of low-skilled workers. On collective bargaining, Blanchard and others (2013) argue that in theory a combination of national and firm-level bargaining seems attractive—the former provides a mechanism for economy-wide changes in wages when an adjustment is needed, and the latter provides a way to allow some differentiation across "space" (firms, sectors, regions). In practice, however, if trust exists among social partners, other collective bargaining structures can also deliver macroflexibility.

5. How much of this framework and how many of these prescriptions carry over to the case of emerging market and developing economies? On a broad level, the distinction between micro- and macroflexibility is useful. Emerging market and developing economies typically need more of both types of labor market flexibility than advanced economies: they have greater needs for carrying out sectoral reallocation of labor, and their economies are typically subject to larger macroeconomic shocks. However, the "separation" proposed by Blanchard and others (2013), whereby certain institutions matter more for microflexibility and others more for macroflexibility, does not hold so well for emerging market and developing economies. In particular, the setting of minimum wages and the structure of collective bargaining can play a comparatively stronger role even in determining microflexibility.

6. Going beyond these general observations, the specific findings are summarized below under three headings: (1) the combination of UI and EPL, (2) the role of minimum wages and collective bargaining, and (3) benchmarking IMF recommendations against the lessons from the literature.

Combination of UI and EPL

- The need for labor market institutions that provide insurance against the risk of income loss is greater in emerging market and developing economies than in advanced economies. However, risks of policy failure are also greater owing to widespread informality and limited administrative capacity. This implies that emerging market and developing economies typically end up with a more restricted set of policy choices than advanced economies, often resulting in both more distortive and less protective policies. In particular, insurance against income loss tends to rely relatively more on distortionary policies (such as overly stringent EPL, which protects only a fraction of formal, regular workers) than on broad-based UI. As countries develop and informality is reduced, the case can be made for gradually rebalancing labor market institutions away from EPL toward UI; that is, expanding UI while converging toward less stringent, simpler, more predictable, and more homogenous EPL.

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- Such gradual rebalancing requires that UI systems be well designed and complemented by other policies to contain the risks of moral hazard. Individual UI savings accounts can play a role, supplemented by a redistributive component to achieve government's equity objectives. So can complementary policies that help reduce informality, including other labor market and tax policy reforms. While administrative capacity is being enhanced, well-designed cash transfers (which do not involve complex monitoring and enforcement of job search and work availability criteria) can be a cost-effective way of providing income support targeted to the poor.

Role of minimum wages and collective bargaining

- Statutory minimum wages are helpful to alleviate in-work poverty and reduce income inequality. At the same time, poor targeting and the possible adverse effects on formal (if not overall) employment if they are set too high suggest that minimum wages should be complemented by other, better targeted tools. These might include cash transfer programs or, where possible, earned income tax credits.

- Collective bargaining can play a useful complementary role in setting wage and broader working conditions, at least at the firm level. For bargaining at a higher level (for example, industry or regional), stricter conditions arguably have to be met to enhance equity without undermining efficiency, including a high degree of representativeness, coordination, and trust between bargaining parties. These conditions are typically much more difficult to meet in emerging market and developing economies than in those advanced economies with deep social dialogue roots, making it harder to make sector-level bargaining work.

IMF recommendations

- Overall, IMF recommendations have been broadly consistent with the available consensus on how to foster flexibility while strengthening safety nets. They have also evolved over time along with the increasing emphasis on inclusive growth. Advice has included introducing or expanding UI systems in a number of cases and, more strongly and more often, easing EPL. At the same time, the complementarity of UI with active labor market policies and the need to consider the design of UI and EPL in tandem have not received much attention.

- While the pervasiveness of informality is often mentioned, the issue of how best to design labor market institutions (UI, EPL, and the level of the minimum wage) in the presence of informality has not been tackled in depth so far. Focusing on this issue will help enhance the granularity of future labor market policy advice.

- Advice on collective bargaining is becoming prominent in the IMF's labor prescriptions, including those for some emerging market and developing economies. The key in this area is to focus on the detailed features that can make the difference between a functioning and a dysfunctional system, most crucially for sector-level bargaining.

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- Efficiency and equity considerations are being integrated into the provision of advice on labor markets, consistent with the increasing emphasis on inclusive growth. For example, recommendations on lowering or restraining the growth of the minimum wage for efficiency considerations are more likely than in the past to include a discussion of alternative ways of supporting workers.

7. The remainder of this note is organized as follows. The next section examines available theory and evidence on the design of labor market institutions in emerging market and developing economies. The following section identifies IMF recommendations for the sample of countries over 2005–16 and benchmarks them against the literature. The final section concludes.

DESIGNING LABOR MARKET INSTITUTIONS IN EMERGING MARKET AND DEVELOPING ECONOMIES: THEORY AND EVIDENCE

A. Are Emerging Market and Developing Economies Special?

8. Labor market institutions provide (various forms of) insurance against the risk of income loss, and they often pursue inequality and poverty reduction objectives, either explicitly (for example, social assistance programs) or implicitly (for example, UI systems that entail de facto income redistribution toward groups at higher risk of income loss).

9. Because equity objectives can in principle be pursued through other policy tools (for example, the tax system), efficiency arguments have provided the strongest theoretical rationale for labor market institutions. The following market failures and imperfections provide a rationale for public policy intervention.

- *Information asymmetries*. Information regarding job loss risk and job search effort is asymmetric, creating moral hazard and risks of adverse selection.[2] As a result, private UI markets may fail or remain underdeveloped, as has been the case even for advanced economies in which public UI provisions are not generous. Credit constraints imply that self-insurance is an imperfect substitute, even leaving aside the fact that it provides no risk sharing. These limits to insurance and credit markets yield a clear case for a collective UI system to smooth consumption (Blanchard and Tirole 2008; Chetty 2008). Likewise, minimum wages can help overcome moral hazard by acting as “efficiency wages” that motivate workers and boost their productivity.

[2] This includes asymmetric information regarding the timing of future job losses, which workers tend to know about before potential insurers do (Hendren 2017). This further amplifies the adverse selection problem and risks that private markets may fail.

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- *Externalities*. Insofar as a collective unemployment benefit system is needed, laying off a worker imposes a financial cost on society that the firm does not internalize. This provides a case for layoff taxes (Blanchard and Tirole 2008).[3]

- *Transaction costs*. The state can in principle collect contributions to a benefit system and distribute benefits more cost-effectively than a private agency can because it already runs tax and spending policies and thus has established administrative capacity (for example, information records regarding taxpayers and spending recipients, tax collection, and benefit distribution vehicles).[4]

- *Monopsony power of firms and other risks of employer abuse owing to uneven bargaining power*. This situation provides a rationale for minimum wages and labor regulations.

10. The case for addressing market failures needs to be weighed against the risk of policy failure. For example, although the risk of moral hazard can be potentially better contained under a public UI scheme than under a private one, it is always a concern, as monitoring is intrinsically imperfect and costly. This concern is compounded by the broader risk that policy design might be far from optimal, reflecting pressures from interest groups and, more generally, the nature of the political decision process. For example, EPL typically does not come in the form of layoff taxes but instead often consists of distortive administrative constraints and procedures regarding layoffs. Likewise, collective bargaining systems might be partly designed by and for large firms, with adverse effects on small and medium-sized enterprises. As for minimum wages, they are often the subject of politically heated debate, which can lead to excessively high or low levels.

11. A defining feature of emerging market and developing economies is that both market failures and policy failures are larger than in advanced economies. Larger insurance and credit market imperfections and less personal wealth available for consumption smoothing mean that the potential welfare gains from UI are greater in emerging market and developing economies than in advanced economies (Chetty and Looney 2006). At the same time, the risks of policy failure are substantially greater for two reasons. The first reason is that limited administrative capacity makes it harder to raise dedicated tax revenue (for example, to finance UI and other types of benefits); to provide benefits (for example, reaching out to potential recipients); to monitor recipients (for example, of UI benefits); and to enforce the law (for example, EPL). The second reason is that widespread informality, whatever its causes, compounds the administrative capacity issue (for example, monitoring job searches of UI recipients).

12. The risks of policy failure owing to informality and limited administrative capacity imply that emerging market and developing economies typically face a more restricted set of policy choices

[3] It also provides a case for experience rating—the method by which an employer's contributions to the unemployment insurance system vary based on its own experience laying off workers.

[4] Also, a single provider can exploit large economies of scale, although this factor alone need not imply that the provider should be the state.

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than advanced economies, even though the case for policy intervention is greater for the former. For example, while economic theory provides a case for protecting workers through UI rather than protecting jobs through EPL, in practice it is difficult to extend social protection coverage without creating important distortions in many emerging market and developing economies. Giving (noncontributory) informal workers access to social benefits financed by formal workers undermines formal work incentives both directly (by creating a wedge between informal and formal sector pay) and indirectly (by putting upward pressure on social spending and formal labor taxation, and thereby the wedge). These distortions are amplified when benefit receipt has an adverse effect on labor supply (as is the case with UI benefits but not health benefits, for example) and recipients cannot be properly monitored. As a result, policymakers are often restricted to a few suboptimal options; namely, covering (1) only formal workers, (2) both formal and informal workers but with high benefits and high distortions, or (3) both formal and informal workers but with low benefits and low distortions, often supplemented with tight, distortive, or poorly enforced EPL restricted to the formal sector.

13. These considerations, over and above general lessons from advanced economies' experience, guided our analysis of how to design and sequence the buildup of labor market institutions in emerging market and developing economies.[5]

B. Unemployment Insurance and Social Assistance

UI: Key design challenges and lessons in an emerging market and developing economy context

14. UI can enhance the individual and social welfare of risk-averse workers by smoothing consumption in the presence of credit and insurance market failures, particularly in emerging market and developing economies, where such failures are typically greater (Chetty 2008; Chetty and Looney 2006). By addressing credit constraints, UI also enables the unemployed to look for better jobs that match their skills; this can improve the quality of job matches and, ultimately, productivity (Marimon and Zilibotti 1999; Tatsiramos 2009). By providing insurance to risk-averse workers, UI can also induce them to take greater risks—seeking higher-paying but higher-unemployment-risk jobs—and thereby raise aggregate output through this risk-taking channel (Acemoglu and Shimer 1999).

15. While these arguments provide a case for unemployment benefits, they do *not* imply that full insurance—a 100 percent replacement rate for the duration of the unemployment period—would be optimal, particularly in the case of emerging market and developing economies. This is because the choice of benefit levels and duration must strike a balance between, on the one hand,

[5] The focus will be on core labor market institutions that affect the broad functioning of labor markets, including UI, EPL, minimum wages, and collective bargaining; in this context, related labor taxation and active labor market policies will also be discussed. The note does not touch on other institutions, such as child care policies or early retirement schemes, that specifically affect certain groups in the labor market.

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providing income loss insurance and, on the other hand, maintaining job search incentives and avoiding excessive wage levels to ensure continued low unemployment (see, for example, Blanchard and Tirole 2008).[6] These issues are compounded in emerging market and developing economies, where risks of moral hazard may be stronger than in advanced economies (and therefore optimal UI generosity may be less) for two complementary reasons: (1) poorer monitoring and enforcement of eligibility and job search criteria,[7] and (2) greater opportunities for the unemployed to take up an informal job while collecting UI benefits, which may further lower incentives to search for a formal job (Alvarez-Parra and Sanchez 2009; Hopenhayn and Nicolini 1999).[8] This situation calls for keeping benefit generosity lower in emerging market and developing economies and enhancing it only gradually along the development path as administrative capacity improves and informality declines. At the same time, provided they are of short duration, UI benefits can enhance rather than weaken job search by increasing the income of unemployed persons and thereby enabling them to devote less time to informal work and more time to securing a job in the formal sector (Bardey, Jaramillo, and Pena 2015).[9] This is likely to be most relevant for low-income, credit-constrained individuals, which argues for granting them higher benefit replacement rates, all else equal.

16. These considerations go a long way toward explaining why UI coverage and generosity are typically much lower in emerging market and developing economies than in advanced economies. While UI systems exist in virtually all advanced economies, they have been introduced in only a small number of emerging market economies and an even smaller number of low-income countries (Figure 1). Likewise, among those countries where a UI system exists, benefit coverage is much greater in advanced economies than in emerging market economies and low-income countries (Figure 2).

[6] High and long-lasting benefits can raise wages and equilibrium unemployment when workers can (re)negotiate wages after they are hired—a realistic assumption in practice (Blanchard and Tirole 2008).

[7] This comes on top of poor administrative capacity to collect taxes, manage UI funds, and distribute benefits, which is a technically related but conceptually separate obstacle to UI provision in emerging market and developing economies.

[8] A mitigating factor is that employment rates in the formal sector may be low to start with, even in the absence of any behavioral effects from benefit receipt. Gerard and Gonzaga (2016), using a model calibrated on Brazilian data, find that informality matters less for optimal UI generosity than usually thought.

[9] Using individual data for Brazil and an empirical strategy that identifies both effects, Hijzen (2011) finds that both moral hazard and, to a lesser extent, this liquidity effect account for the impact of benefit receipt on the duration of formal unemployment.

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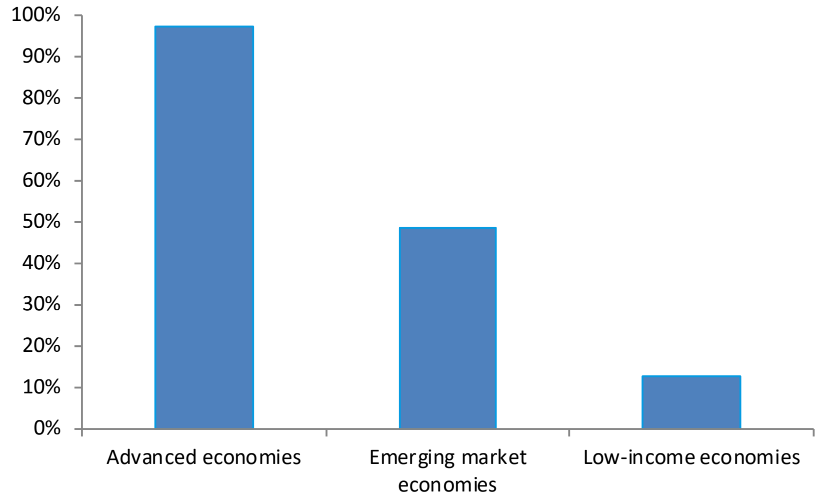
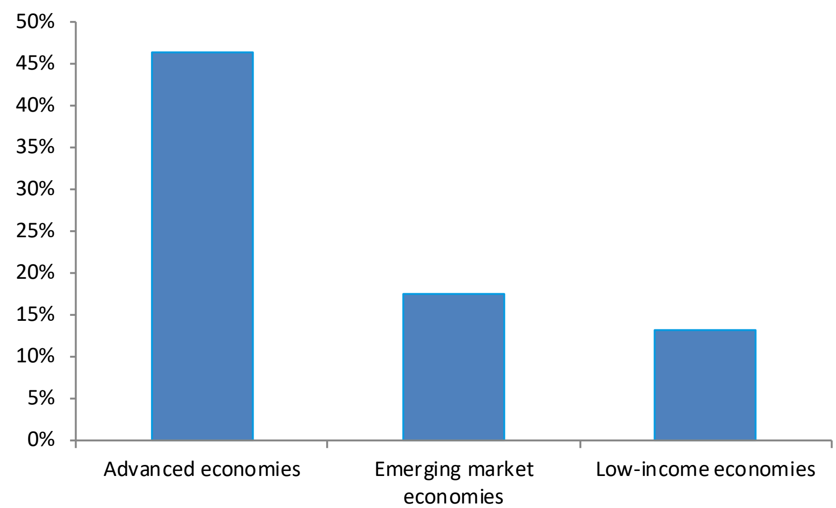
Figure 1. Share of Countries with an Unemployment Insurance System
(2014, by country income group, percent)



Sources: Author calculations; and International Labour Organization (2014).

Figure 2. Unemployment Benefit Coverage
(2013, percentage of unemployed workers receiving benefits, by country income group)



Sources: Author calculations; and International Labour Organization (2014).

17. One way to enhance UI provision in emerging market and developing economies—and in general—without creating significant economic distortions is to rely on unemployment individual savings accounts (UISAs). In the canonical version, under which benefits are financed solely through mandatory individual savings, workers incur the full cost from drawing down their accounts, unlike under a conventional UI system, in which risk pooling across workers induces job search disincentives as workers do not fully internalize the social cost of benefit receipt (for theory, see, for example, Brown, Orszag, and Snower 2008; for empirical evidence on Chile, where UISAs and a UI

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system coexist, see Hartley, Van Ours, and Vodopivec 2011).[10] Also, because contributions to UISAs represent individual savings while contributions to a UI system are typically perceived at least in part as taxation, the former are more likely to reduce reservation wages compared with the latter, thereby increasing labor demand.

18. UISAs come with two important limitations, however. First, if they are poorly designed, they might undermine some other dimensions of economic efficiency by creating distortions. For example, they might foster excessive labor turnover if workers are myopic or credit-constrained, or get below-market-rate returns on their savings and therefore seek to run down their accounts for other purposes—as seems to have happened in Brazil (see, for example, Ribe, Robalino, and Walker 2010). Second, and more fundamentally, UISAs may not provide sufficient insurance for certain categories of workers. When UISAs are financed solely through individual contributions, even a 15 percent contribution rate on wages and a 7 percent rate of return on savings provides only about four months of benefits in the event of job loss after two years of work. This is unlikely to provide sufficient coverage to workers with shorter contribution periods and greater unemployment risk, such as young, unskilled workers. Countries in which UISAs exist (for example, Chile) have maintained some degree of risk pooling through a state-provided UI system.[11]

19. So how can the twin and conflicting goals of expanding UI coverage and preserving work (as well as saving and insurance) incentives be achieved against the background of weak administrative capacity and pervasive informality? One way forward for UI and social protection schemes more broadly could be to move gradually toward a two-tier system featuring (1) a mandatory, nonredistributive first tier fully funded by individual contributions (for example UISAs) and (2) as a complement, transparent and progressive subsidies, financed through general taxation, to enhance coverage of low-income workers with limited saving capacity, including by encouraging informal workers to opt into the contributory system. This approach is roughly in line with World Bank advice for Latin America and the Caribbean (Ribe and others 2010).

20. A two-tier system would minimize, although not fully eliminate, the efficiency cost of extending insurance coverage. The first tier (UISAs) would minimize disincentive problems for formal workers. The second tier (the redistributive component) would achieve its inequality and poverty reduction objectives without discouraging informal workers from taking formal jobs. Compared with a standard risk-pooling system—under which redistribution is less transparent, less controlled, and therefore less well targeted—this approach would yield efficiency gains through better targeting and lower labor tax wedges.[12] Some efficiency costs would remain, however, owing to the effective

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[10] A continuum of design options exists between a pure UISA and a pure unemployment benefits system, depending on the targeted degree of risk pooling, which in turn depends on what taxes are used to finance the benefits and will ultimately reflect social preferences regarding efficiency versus redistribution/equity (see, for example, Robalino 2014).

[11] Furthermore, while UISAs raise smaller administrative and incentive concerns compared with UI systems, they are not free of such issues. In particular, a minimum degree of financial development and macroeconomic stability is required to manage USIAs and to foster workers' confidence in them.

[12] Where multiple schemes already exist, their consolidation would have the advantage of increasing efficiency by broadening the insurance risk pool, further reducing administrative costs and labor taxation, and facilitating portability and thereby labor mobility.

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marginal tax rate stemming from subsidy withdrawal as individual income goes up. These costs can be reduced by avoiding threshold effects arising from kinks in the subsidy withdrawal rate.

Complementary policies to make UI systems work

21. The efficiency of UI systems depends not just on their design features but also on the implementation of complementary policies to address informality, measures to activate benefit recipients, and tax policies that keep the distortions created by the financing of the system at low levels. The more of such policies in place, the smaller the economic distortions caused by unemployment insurance are likely to be, which allows the system to cover more people and provide more generous benefits. In introducing or expanding UI, it is crucial to exploit these complementarities between different policies and institutions.

22. Informality must be reduced over time and administrative capacity enhanced as the government expands the coverage and generosity of the UI system. The causes of informality are numerous and complex; some of them, such as low productivity of certain activities or low optimal firm size, are outside the immediate reach of governments and can be addressed only gradually as economic development proceeds (Kanbur 2015). However, governments can and should address the regulatory causes of informality, including those arising from labor market policies and institutions. These include EPL, minimum wages, and labor taxation (discussed below), but also the provision of social insurance, including UI. Depending on how the UI system is designed, the buildup of UI might reduce or increase informality, reflecting two offsetting forces (Bosch and Esteban-Pretel 2012). UI makes it more attractive for workers to find a formal job, but financing UI through labor taxation increases informality.[13] Ribe and others (2010) suggest that the latter effect dominated when UI was introduced in Mexico.

23. High labor tax wedges can reduce formal employment and possibly overall employment in emerging market and developing economies (Betcherman, Daysal, and Pagés 2010; Heckman and Pagés 2004; Kugler and Kugler 2009; Kugler, Kugler, and Herrera 2017). Binding minimum wages, in particular, increase the pass-through from payroll taxes onto labor costs. They should be reduced where they are high in comparison with other nations and kept low elsewhere; other, less distortive sources of financing should be considered. Even though social protection systems are much less developed in emerging market and developing economies than in advanced economies, average labor tax wedges (which include employer and employee social contributions as well as personal income taxes) are largely similar, although wide variation exists among countries. A 2010 World Bank study (Ribe and others 2010) puts the worldwide emerging market and developing economy average at about 35 percent, fairly close to the average tax wedge across Organisation for Economic Co-operation and Development (OECD) member countries (OECD 2010). Much scope exists for shifting the burden of taxation away from labor toward other taxes in most emerging market and developing economies. For example, consumption taxes are less likely than labor taxes to distort the

[13] UI—particularly UISAs, which provide a stock rather than a flow of funding—can be used as starting capital for informal self-employed work, facilitating the transition from formal to informal employment.

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decision to create and take up formal versus informal jobs, as they equally affect formal and informal workers; this is a further argument in favor of introducing or extending the use of Value-Added Taxes (VAT) in emerging market and developing economies, over and above its many other merits.[14] Other tax and spending reforms also have a role to play to reduce labor taxation, such as broadening tax bases in the context of a simplification of the tax code or cutting inefficient public spending, including in categories (such as energy subsidies) that have been used as highly inefficient de facto social transfer schemes.

24. Finally, a well-functioning UI system can help and incentivize benefit recipients to look for jobs through strong enforcement of job search requirements and well-designed active labor market policies. The more effectively job search is supported and encouraged, the smaller the adverse incentive effects of UI and the more generous the system can be. Advanced economies that have managed to provide generous benefits while keeping employment levels high, such as some Nordic countries, have typically put strong emphasis on activation: the so-called flexi-security model (see, for example, OECD 2006, 2018). The difficulty of designing and implementing effective active labor market policies in emerging market and developing economies may result in lower UI benefit levels and shorter duration of benefits than in advanced economies. However, for a given degree of UI generosity, developing active labor market policies in parallel with the buildup of UI schemes might be even more important in emerging market and developing economies than it is in advanced economies for two reasons: (1) mandatory participation in active labor market programs (for example, job search activities) can partly substitute for job search monitoring—which is plagued by weak administrative capacity—and thereby help ensure that the unemployed do not work in the informal sector while receiving benefits; and (2) such programs can strengthen the insertion and labor market attachment of the most vulnerable categories of job seekers (youth and those with low skill levels) and, more broadly, help reduce locational, sectoral, and job mismatches.

25. For an active labor market policy to pass a cost-benefit analysis test, it must explicitly target well-identified labor market failures. While this sounds obvious, the evidence suggests that many programs have not met this simple criterion. The booming literature on the impact of active labor market policies on employment and income has so far produced mixed results for both advanced economies and emerging market and developing economies (for recent reviews, see, for example, Crepon and van den Berg 2016, and McKenzie 2017). Returns on individual programs have been widely heterogeneous, even leaving aside thorny issues such as scalability or displacement effects.[15] Tentative evidence exists that certain interventions, such as those that target geographical and sectoral mobility, may work better than others, but much more research is needed before general lessons can be drawn with any degree of confidence. Meanwhile, a sensible policy approach is to

[14] VAT itself can promote informality by encouraging consumers and firms to purchase VAT-free goods and services, especially if the VAT rate is set high. This is another reason for the UI system to be highly efficient and to achieve broad coverage: to keep overall tax rates as low as possible.

[15] For evidence of sizable displacement effects in an AE context, see Crepon and others (2013).

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evaluate programs systematically, discard those that fail to pass a cost-benefit test, and gradually scale up and reassess those that do.

Social assistance and cash transfers

26. Cash transfers, a form of social assistance that provides financial support to the poor, can complement UI. However, they are often used as a substitute in many emerging market and developing economies, where the UI systems are still in their infancy. In the presence of weak administrative capacity, well-designed cash transfers can be a cost-effective (less distortive and better targeted) way of providing income support to the poor. They can be unconditional (for example, Dibao in China) or conditional, typically on participation in education or health programs (for example, Bolsa Familia in Brazil). Sizable and well-designed cash transfer programs can reduce poverty; if they are complemented by quality government programs, they can also enhance investment in education and health.

27. An important challenge is to design such schemes to minimize any work disincentives that might arise directly from benefit receipt itself or indirectly from its financing. According to conventional labor supply theory, benefit receipt could induce adverse income and substitution effects on participation in the formal job market. Higher income increases demand for leisure, while benefit receipt (means-tested or conditional on not working) increases the marginal tax rate if the individual takes up or increases hours of formal work. These effects are likely to be small, as benefit levels are often fairly modest,[16] target a population (the poor) whose leisure elasticity to income is small, are typically unconditional on labor market status, and are seldom carefully means-tested owing to weak administrative and enforcement capacity. Furthermore, cash transfers might improve the formal labor force participation of the poorest by easing their liquidity constraints and enabling them to devote some time to job search (see, for example, OECD 2011). Nonetheless, benefit levels should not be set too high, and as countries develop means-testing they should be enforced in ways that minimize the substitution effect—for instance, through gradual phasing out of benefits, as is common practice in many advanced economies.[17] Making some cash transfer receipts conditional on participation in well-designed training programs might also encourage labor market participation.

C. Employment Protection Legislation

The two components of EPL

[16] For example, depending on the recipient's income and family situation, benefit levels under the Bolsa Familia program in Brazil ranged between 2 percent to a maximum of about 15 percent of the average wage in 2015. For details, see, for example, Gazola Hellman (2015).

[17] Efficiency also requires accurate and up-to-date beneficiary registers and transparent financial management of the system more broadly, which in turn requires a minimum level of administrative capacity. This is especially important where benefit levels are higher or cover a wider share of the population (for example, in urban areas).

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28. EPL can be used to pursue multiple objectives, but a central one is to provide some insurance to workers against the risk of dismissal and thus income loss (Pissarides 2001). On this front, an important and largely undisputed role of EPL is to address noneconomic motives for dismissals and thereby protect workers against abuse and discrimination. However, the issue of whether (and, if so, how) EPL should be used to address dismissal for economic reasons is more frequently debated and central to the literature. This issue is focused on here.

29. Although the empirical literature is unsettled and still evolving (see, for example, Betcherman 2012), it has documented that EPL can have the following effects.

- *Reducing productivity* (Autor, Kugler, and Kerr 2007; Bassanini, Nuziata, and Venn 2009; Eslava and others 2004; Hopenhayn and Rogerson 1993), although this effect might be less in developing countries, where the rule of law and EPL enforcement in the formal sector are particularly weak (Caballero and others 2004). The primary and well-documented negative impact of EPL is on job turnover and thus on the reallocation of labor across firms and industries (Bassanini and others 2010; Cingano and others 2010; Micco and Pagés 2006). For the same reason, overly stringent EPL can discourage venture capital and weaken innovation (Bozkaya and Kerr 2014). However, the estimated effects of EPL on productivity have generally been found to be small, perhaps owing to two positive effects. First, strict EPL induces firms to select more productive workers—with an associated cost in the form of increased labor market dualism (see third bullet item). Second, by increasing the expected tenure in the job, it might increase on-the-job-training from otherwise suboptimal levels (Wasmer 2006).
- *Raising unemployment duration* by lowering job turnover (for example Bentolila and Bertola 1990; Pissarides 2000) and possibly reducing employment as well. On the latter front, while the evidence is theoretically and empirically ambiguous, available studies provide slightly stronger evidence of adverse effects for developing countries (Ahsan and Pagés 2009; Botero and others 2004; Djankov and Ramalho 2009 for a review; Fallon and Lucas 1991; Heckman and Pagés 2004; Kugler 2004) than for advanced ones (for a summary, see OECD 2013; for recent IMF evidence, see Duval and Furceri 2018 or Duval, Furceri, and Jalles 2017).
- *Increasing labor market dualism*. In developing countries, an extreme, dominant form of dualism is the presence of a large informal sector alongside the formal sector (Besley and Burgess 2004; Bosch and Esteban-Pretel 2012; Bosch, Goni-Pacchioni, and Maloney 2012).

30. EPL has two conceptually different components, between which the empirical literature rarely discriminates: (1) a transfer component that includes, for example, severance payments or the notice of termination—the latter amounts to a transfer of information that has economic value (Pissarides 2001); and (2) a tax component that consists of all the administrative procedures involved in individual worker and collective dismissals and does not entail any transfer to the dismissed worker(s).

31. While the tax component of EPL is intrinsically distortive, the transfer component is not necessarily so. In the absence of contractual and market frictions, wage negotiation between firms

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and workers could be such that predictable severance payments have no effect on labor market equilibrium. Forward-looking firms internalize the expected cost of future severance pay by reducing their entry wage offer, thereby leaving the expected cumulative cost of the employment relationship unchanged (Lazear 1990; Pissarides 2001). Because it rests on strict conditions, this prediction is unlikely to hold in practice; in the absence of full contractual flexibility in the wage-setting process (that is, in the presence of wage rigidities), severance payments can have allocative effects, including on employment (Garibaldi and Violante 2005). Nonetheless, the key message from theory is that the transfer component is likely to be less distortive than the tax component.

32. Therefore, policymakers should try to keep the tax component low. What about the transfer component? Is there a case for a mandatory transfer component (essentially severance pay), and how does this case depend on the presence and design of UI?[18]

EPL versus UI

33. UI is conceptually superior to EPL in providing insurance against income loss. In the presence of optimal UI, theory suggests that EPL should only take the form of a layoff tax that forces firms to internalize the social cost of layoffs; there would be no case for a transfer to workers, such as severance pay, other than to compensate for the psychic cost of losing a job, which might rise with seniority (Blanchard and Tirole 2008). This is because severance pay suffers from two fundamental weaknesses relative to UI: (1) being a one-off payment to the worker, it provides no insurance against unemployment duration risk; and (2) it offers no risk sharing across workers in different firms, which, coupled with a lack of prefunding, increases the risk of nonpayment, as the likelihood of having to dismiss workers correlates negatively with the firms' solvency and liquidity. Over and above these two serious limitations, severance pay raises further practical issues: (1) its enforcement requires a well-functioning and adequately funded administrative and judicial system, which partly explains why it is much weaker in emerging market and developing economies than in advanced economies; (2) litigation costs can be significant; (3) many workers do not qualify owing to short tenure or are not covered owing to informality; and (4) the growing fragmentation of work (and its corollary, the growing complexity of contractual relationships between employers and employees) calls for portability of rights across different forms of labor; that is, for protecting workers (through UI) rather than jobs (through EPL).

34. Despite the conceptual superiority of UI, the labor market institution mix in emerging market and developing economies relies comparatively more on EPL and less on UI than in advanced economies. While UI is still in its infancy in most emerging market and developing economies, the average stringency of EPL differs only marginally from that observed in advanced economies (Figure

[18] The focus here is on public institutions, ignoring voluntary transfer arrangements between firms and workers. Firms have long offered severance pay to their workers as a way to reduce voluntary quits and the associated loss of human capital investment (see, for example, Holzmann and others 2011). Lazear (1990) lays out the theoretical case for such arrangements.

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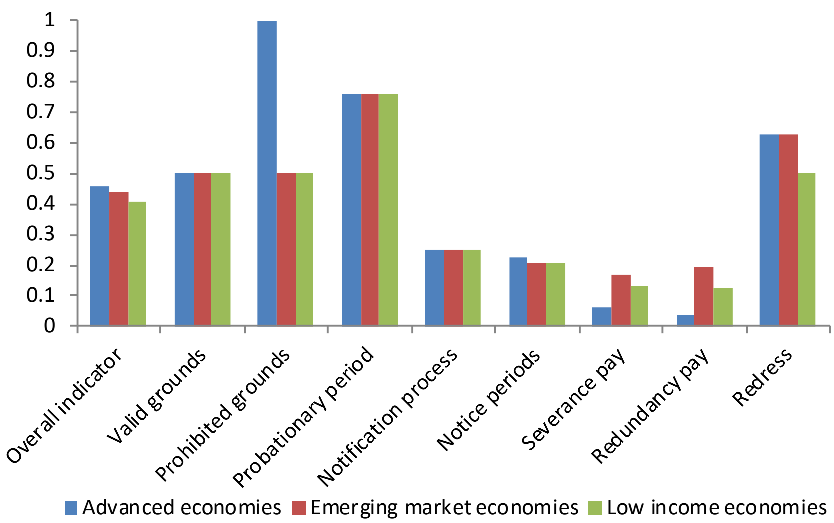
3).[19] This holds across most of the components of EPL, including both administrative procedures and, particularly, transfers to dismissed workers. The practical limitations of UI noted earlier may partly underpin the rather high average severance payments mandated by EPL in emerging market and developing economies and might contribute to the mild substitutability between UI and EPL across countries (Figure 4).[20] Still, much room seems to exist for reform in this area and even more so for streamlining administrative procedures, and the tax component of EPL. Beyond the severance pay issue, most existing systems could also be better designed. In particular, deferred compensation (so-called severance savings, which can be drawn upon after any dismissal or voluntary quit) can provide more efficient income insurance than a transfer upon being laid off. This is because deferred compensation avoids nonpayment by the firm—a frequent issue in emerging market and developing economies—while delivering better employment performance (for example Heckman and Pagés 2004).

Figure 3. Employment Protection Legislation for Regular Contracts: ILO EPLex Indicator and Components

(2010, scale 0–1, country income group median)



Source: International Labour Organization.
Available at http://www.ilo.org/travail/areasofwork/WCMS_435450/lang--en/index.htm. Note: EPLex indicators measure the level of de jure employment protection in a given country and a given year. All indicators are distributed on a 0–1 scale. Lower values represent lower levels of de jure employment protection, while higher values represent higher levels of de jure employment protection. There are eight EPLex component indicators, each governing a specific area of employment protection: valid grounds for dismissals, prohibited grounds for dismissals, probationary period, procedural notification requirements for dismissals, notice periods, severance pay, redundancy pay, and avenues for redress.

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[19] See also OECD (2015).

[20] On the theoretical front, the case for reducing job turnover through EPL relative to UI can be greater (Lommerud, Straume, and Vagstad 2016), the lower is workers' degree of risk aversion is (that is, the less valuable unemployment benefits are to them), the higher the job matching externality (the adverse effect of vacancy posting by one firm on the likelihood that other firms fill their vacancies, which implies "excessive" job turnover in an unregulated labor market), the smaller the degree of worker bargaining power arising from sunk job-specific investments (which create a "hold-up" problem that discourages such investments and therefore job creation).

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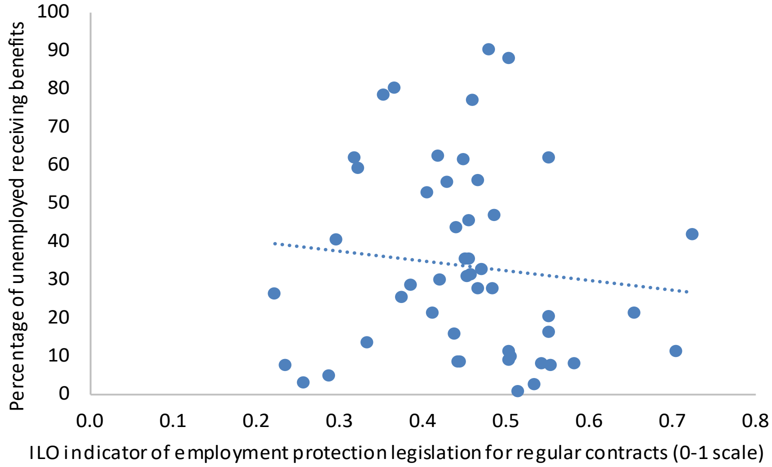
Figure 4. UI Coverage versus ILO Indicator of Job Protection for Regular Contracts
(2013 and 2010, advanced and selected emerging market and developing economies)



Sources: Author calculations; and International Labour Organization (2014, 2015).

Labor market dualism

35. Poorly designed EPL can foster labor market dualism, with adverse implications for both efficiency and income inequality. This is one important lesson for emerging market and developing economies from past experience in a number of advanced economies, where EPL for regular contracts remained largely unchanged while temporary contracts were deregulated beginning in the 1980s, in part to address demands for contractual flexibility and in part owing to political obstacles to more widespread deregulation. Such partial deregulation can foster the creation of temporary jobs and discourage their conversion into permanent ones, thereby increasing worker turnover and creating a two-tier system under which stable, regular jobs held primarily by higher-skilled prime-age workers coexist with unstable jobs held primarily by more disadvantaged groups, such as youth, migrants, and low-skilled women (see, for example, Boeri 2010; Centeno and Novo 2012). Beyond its negative impact on equity (see, for example, European Commission 2010), asymmetry between regular and temporary job protection and the resulting increase in job and worker turnover can have an adverse effect on aggregate unemployment (Blanchard and Landier 2002), on-the-job human capital accumulation, and productivity.

36. These costs of EPL fragmentation have led some to advocate a single labor contract (for example Blanchard and Tirole 2003). While this remains an aspirational goal more than actual institutional practice even in advanced economies, the general lesson is that reducing contract dualism would help reduce labor market dualism. This objective could be better supported by targeting only mild, rather than stringent, protection levels for all workers. This approach could be particularly important for emerging market and developing economies, where overly stringent job protection for regular workers can itself foster labor market fragmentation (for example, job seekers

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queuing for highly protected jobs in the public sector) and informality (which is ultimately an extreme form of labor market dualism that can increase inequality).[21]

Way forward

37. Overall, the discussion in this section suggests a strong case in emerging market and developing economies for expanding UI gradually along the economic development path while converging toward less stringent, simpler, more predictable, and more homogenous EPL. EPL should be moderate to minimize its economic costs and the adverse side effects on equity among different groups of workers. It should be simple and predictable, taking the form of well-designed severance pay rather than burdensome administrative procedures with uncertain outcomes. Finally, it should be homogenous, rather than fragmented into multiple types of contracts that provide widely different protection levels, notably for regular and temporary workers.

D. Minimum Wages and Collective Bargaining

Minimum wages

38. Minimum wages pursue two fundamental objectives. One is to address market failures and promote economic efficiency, an objective for which minimum wages are well suited provided they are well calibrated. In particular, minimum wages can alleviate risks that firms' monopsony power might lead to excessively low market wages and employment or improve workers' productivity in a context in which their work effort cannot be fully observed owing to information asymmetry (Shapiro and Stiglitz 1984). The other objective, which is broader and more challenging, is to reduce overall inequality, for which minimum wages compete with other policy instruments, notably tax-benefit systems.

39. The effectiveness of minimum wages in reducing wage inequality and poverty is weakened by a number of factors, some of which may be more prevalent in emerging market and developing economies. One limitation is that minimum wages are rather poorly targeted; they target individuals rather than households, and employed workers rather than both employed and unemployed people. In an emerging market and developing economy context, targeting is generally even poorer, since minimum wages apply only to workers on formal jobs,[22] although they can partly spill over to the informal sector by serving as a focal point for wage demands and through labor mobility—the so-called lighthouse effect (see, for example, Cunningham 2007). The smaller the share of formal workers in total employment and the less they live in poor households, or the higher the starting level of the minimum wage (which determines whether it is binding only for low-income households or for middle-income households too), the less the minimum wage reduces inequality (see, for

[21] Dualism has been particularly strong in some commodity-exporting emerging market and developing economies, where it has been magnified by the prevalence of public sector employment, dualism between domestic and expatriate workers, or employment quotas over and above the role of stringent EPL (see, for example, IMF 2014).

[22] In particular, subsistence farmers, the self-employed, and in some cases workers on small firms are not covered.

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example, Gindling 2014). A further issue in many emerging market and developing economies is low compliance among supposedly covered workers. These considerations point to complementarities between minimum wages and other policies to address informality and enhance enforcement, such as strengthening administrative capacity and legal systems.

40. The impact of minimum wages on overall inequality also depends on their employment effect, which is the main channel through which they affect economic efficiency.[23] While these employment effects remain hotly debated, [24] an emerging consensus seems to be that they may be small under the levels that have historically prevailed in most countries (see, for example, Kuddo, Robalino, and Weber 2015, or more recent studies discussed in Kugler, forthcoming). But set at too-high levels, minimum wages can have adverse effects on less productive population groups such as less educated youth (Abowd and others 2000; Kramarz and Philippon 2001; Neumark and Wascher 2008).[25] In emerging market and developing economies, a further issue is that the distribution of productivity levels across firms is typically much wider than in advanced economies, often as a result of various distortions in the economy (Hsieh and Klenow 2009).

41. The risks of adverse (overall or at least formal) employment effects must be considered seriously in emerging market and developing economies, as the average ratio of the minimum wage to the median wage across countries that have a minimum wage is higher than it is across advanced economies (Figure 5). This might partly reflect low absolute median wages, which means that the minimum wage needs to be set at a high relative level to fulfill its antipoverty objective. Another factor might be that minimum wages have often been used as a substitute for weak collective bargaining institutions in emerging market and developing economies (Saget 2008).

[23] Minimum wages might also have a positive impact on productivity by encouraging worker effort and shifting activity away from lower-skilled toward higher-skilled firms and industries. The prevalence and magnitude of this effect are unclear, however (see, for example, Sabia 2015). Much more research is needed on this topic.

[24] Assessing the overall employment effects of minimum wages is even more difficult for emerging market and developing economies than it is for advanced economies, owing to the stronger labor mobility between formal and informal sectors and the comparatively much smaller amount of empirical literature (mostly focused on Latin America) in the former.

[25] In a meta-analysis, Betcherman (2012, 2013) argues that the effects of minimum wages and other labor regulations on economic performance are nonlinear; that is, stronger for higher degrees of stringency.

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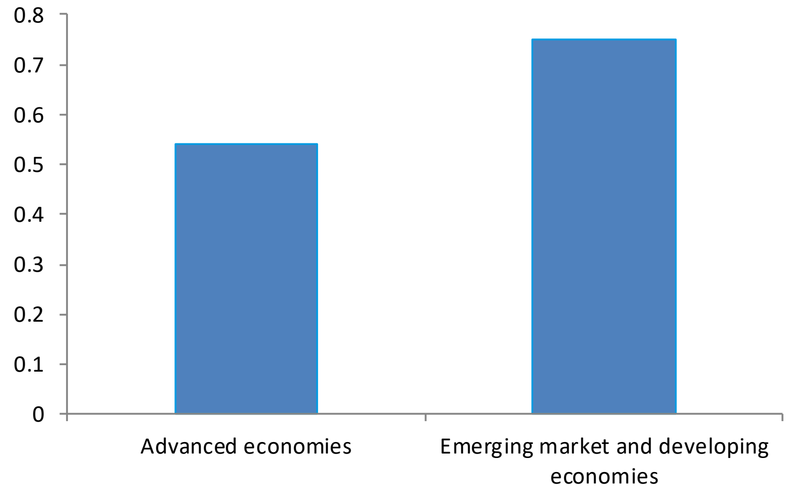
Figure 5. Ratio of Minimum to Median Wage: Selected Emerging Market and Developing Economies and Advanced Economies

(2010, simple average across available countries in each country income group)



Sources: Author calculations; and International Labour Organization, ILOSTAT database). Note: The vertical axis indicates the average ratio of the statutory monthly minimum wage to the median nominal monthly earnings of all employees. Minimum wages are not reported for countries for which they are set through collective bargaining. In cases where a national minimum wage is not mandated, the minimum wage in place in the capital or major city is used. In some cases, an average of multiple regional minimum wages is used. In countries where the minimum wage is set at the sectoral or occupational level, the minimum wage for manufacturing or unskilled workers is generally applied.

42. One way to address any adverse employment effects of too high a minimum wage is to allow for differentiation across population groups, regions, or industries, particularly where productivity levels vary widely along some of these dimensions. An extreme form of differentiation is the outright exemption from the minimum wage legislation of certain categories of workers, such as youth or agricultural workers. By easing risks that less productive categories of workers might be priced out of formal employment, differentiation can also enable governments to set the standard minimum wage at a higher level than would be feasible otherwise. At the same time, a case exists for keeping differentiation simple and transparent (limited to youth, regions, or states, for example) for two reasons: (1) excessive differentiation entails administrative complexity, an acute challenge in emerging market and developing economies, where labor administration services often have low resources and enforcement is challenging, especially where informality is high; and (2) it can weaken the poverty and inequality reduction objectives of minimum wages. When a government differentiates across regions, it must take price levels into account, because the yardstick for measuring equity should be purchasing power rather than nominal minimum wages.

43. Minimum wages also need to be flexible enough to ensure employment resilience to changes in business conditions. This raises the issue of whether adjustments to the minimum wage should be discretionary or should rely on an automatic formula. The latter has the advantage of avoiding lengthy political negotiations and securing outcomes, but it can also impede or delay wage adjustment to adverse macroeconomic shocks, with adverse implications for low-skilled employment. A possible compromise might be regular reviews informed by the recommendations of an independent specialized body, whose impact could range from providing advice to legally setting minimum wages (11 percent of cases globally in 2012; see Table 9 in ILO 2013).

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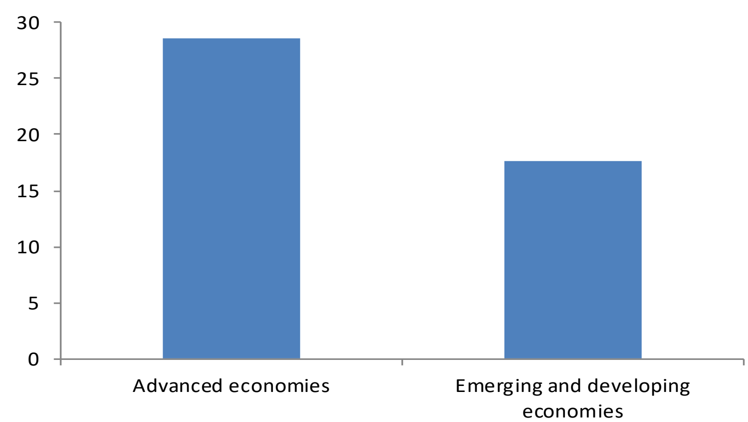
44. In principle, minimum wages set through collective bargaining rather than statutory decisions could bring about the needed differentiation and flexibility, but this is typically even harder to achieve in emerging market and developing economies than in advanced economies. To start with, collective bargaining is less widespread in emerging market and developing economies than it is in advanced economies. According to the International Labour Organization (ILO), only two of the 12 countries in which minimum wages are set by social partners are emerging market and developing economies (Eritrea and Namibia). Setting minimum wages through collective bargaining requires some degree of bargaining centralization, which in turn makes it more difficult to ensure that wages are tailored to local economic conditions except under a high degree of representativeness, coordination, and trust between bargaining parties (see IMF 2016). These conditions are difficult to meet in general but more so in emerging market and developing economies than in advanced economies.

Collective bargaining

45. Union density and collective bargaining coverage rates are far lower on average across emerging market and developing economies than across advanced economies, partly reflecting generally weaker organization of labor (Figures 6 and 7). Bargaining coverage—the share of workers covered by a collective agreement—generally depends on the extent of worker unionization (union density); the predominant level(s) at which negotiations take place (for example, firm, industry, or national); and government policies, notably regarding administrative extensions of collective agreements. Considering the whole workforce rather than just formal sector workers, effective coverage also depends on the degree of informality. Formal sector bargaining coverage is generally low across Asia but widely heterogeneous across countries in Africa and Latin America. In Latin America, coverage has also varied widely over time as a result of shifts in government policies, including toward unions.

Figure 6. Union Density Rates

(2013 or latest available year, percent, simple average across available countries in each country income group)



Sources: Author calculations; and International Labour Organization, ILOSTAT database).

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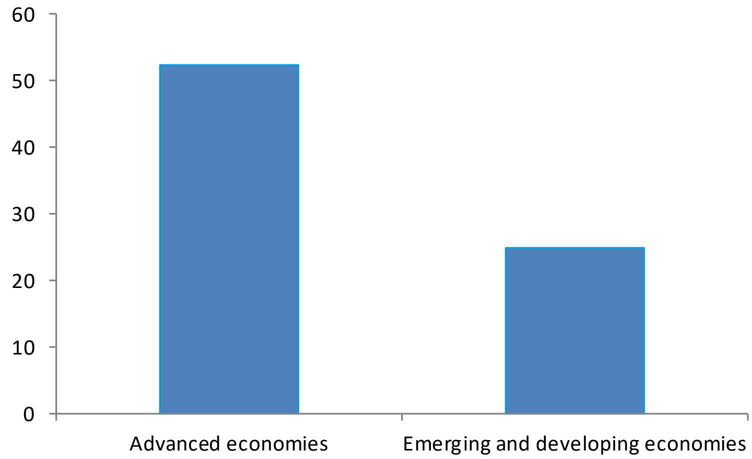
Figure 7. Collective Bargaining Coverage

(Early 2010s/late 2000s, percentage of salaried employees covered by a collective agreement, simple average across available countries in each country income group)



Sources: Author calculations; and International Labour Organization, ILOSTAT database).
Note: The collective bargaining coverage rate measures the number of (formal) employees whose pay and/or conditions of employment ar determined by one or more collective agreement(s) as a percentage of the total number of (formal) employees. Collective bargaining coverage includes, to the extent possible, workers covered by collective agreements in virtue of their extension. Collective bargaining coverage rates are adjusted for the possibility that some workers do not have the right to bargain collectively over wages (for example, workers in the public services who have their wages determined by state regulation or other methods involving consultation).

46. Collective bargaining can improve productivity through various means; for example, by strengthening the functioning of internal labor markets, delivering otherwise underprovided local public goods (such as workplace safety), and addressing other market failures (such as the appropriability problem in general training) (see, for example, Freeman and Medoff 1984). Unions can also help reduce horizontal wage inequality between comparable workers, such as men and women (see, for example, Blau and Kahn 1996; Felgueroso, Perez-Villadoniga, and Prieto-Rodriguez 2008; Hartog, Leuven, and Teulings 2002), as well as overall wage and income inequality (see, for example, Freeman 2010; Jaumotte and Osorio-Buitron 2015). Unions can also complement the role of tax and public spending policies.

47. At the same time, a collective bargaining system needs to deliver both macro- and microflexibility, as noted in the introduction. Lack of such flexibility can lead to inefficient (re)allocation of resources across firms and industries and impede the adjustment of working conditions to shocks, thereby undermining productivity as well as the level and stability of employment.

48. What is known about the practical design features of collective bargaining systems that deliver macro- and microflexibility? One dimension that has received a lot of attention in the literature is the level at which bargaining takes place. Like advanced economies, emerging market and developing economies show wide cross-country heterogeneity in the primary level of bargaining, with an overall trend toward decentralization. This is especially true in Latin America, where centralized bargaining is important in several countries, such as Argentina and Uruguay (see, for example, Lamarche 2015). The "hump-shaped hypothesis" put forward by Calmfors and Driffill (1988) held that highly centralized systems (through macroflexibility achieved by inducing unions to internalize the effects of too-high wage claims on economy-wide employment) and decentralized

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systems (through microflexibility of wages at the firm level) would outperform sector-level bargaining. However, available evidence regarding the hump-shaped hypothesis has been rather mixed. In advanced economies, experiences have diverged noticeably among countries in which sector-level bargaining is widespread, partly because some systems (Germany, Japan, Netherlands, Scandinavian countries) have achieved greater coordination or have provided for higher flexibility at the firm level (for example, through the use of so-called opening clauses)[26] than others (for example, Portugal or Spain).[27] In emerging market economies, available evidence from the major policy-driven decentralization that took place in Argentina and Uruguay in the early 1990s points to a positive impact of firm-level bargaining on productivity (Cassoni, Labadie, and Fachola 2005; Lamarche 2013). Overall, the emerging evidence suggests that, at a minimum, industry-level bargaining systems need to provide for some flexibility at the firm level.

49. Another important and controversial issue has been the role of administrative extensions of collective agreements, which enlarge coverage beyond the members of negotiating parties to all workers in a sector, thereby increasing overall bargaining coverage rates. Extensions are widespread in some European countries, and they play an important role in some emerging market economies, such as in South Africa. They can help reduce transaction costs (especially for small firms, for which bargaining would be costly) and avoid a "race to the bottom" among firms on working conditions. However, by design, they undermine firm-level flexibility by imposing similar working conditions across firms. There is mounting empirical evidence of adverse employment effects of administrative extensions in both advanced economies and emerging market and developing economies (Diez-Catalan and Villanueva 2015; Hijzen and Martins 2016; Magruder, 2012; Martins 2014). Therefore, any use of extensions should ensure that extended provisions do not harm a significant fraction of firms. Extending only agreements that meet stringent union and employer association representativeness criteria can mitigate adverse employment effects (Hijzen and Martins 2016). Retaining some discretionary power on the extension decision, to be used when rapid macroeconomic adjustment is needed, can also help. More research is needed on these issues and in many other areas of collective bargaining, including the elusive but seemingly important role of trust between social partners for macro- and microflexibility (Blanchard and others 2013; IMF 2016).

Way forward

50. To sum up, statutory minimum wages are helpful to alleviate in-work poverty and to reduce income inequality. At the same time, poor targeting and possible adverse effects on formal employment if they are set too high suggest that they might not be the most effective public policy tool and should be complemented by other, better targeted ones. Simple, limited differentiation by

[26] Opening clauses allow firms to set less favorable wages and working conditions than those in the applicable sector-level agreement if certain conditions are met. The resilience of the German labor market during the global financial crisis was attributed to such clauses (Dustmann and others 2014).

[27] Hijzen, Martins, and Parlevliet (2017) discuss how the detailed design features of the sector-level bargaining systems of Portugal and the Netherlands differ along a number of dimensions that might have contributed to the contrasting labor market performance of the two countries.

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regions or population groups (for example, substandard rates for youth) can ease this tension and enable governments to set standard rates higher than would otherwise be possible without hurting the job opportunities of disadvantaged workers. Perhaps even more important, a case can be made for complementing minimum wages with other, better targeted tools, such as conditional or unconditional cash transfer programs or wage subsidies (see, for example, Cahuc and Carcillo 2015), or earned income tax credits where possible. For instance, Barros and others (2010) argue that for a given resource transfer, the Bolsa Familia program in Brazil was more effective than minimum wage increases in reducing poverty and income inequality. As for earned income tax credits, they have been used extensively as a complement to minimum wages in advanced economies and could be deployed more widely in more advanced emerging market and developing economies, where administrative capacity is strong enough to support their use.

51. Collective bargaining can play a useful complementary role in setting wage and broader working conditions, especially if it takes place at the firm level. For bargaining at a higher level (for example, industry or regional) to enhance equity without undermining efficiency, strict conditions would have to be met, including a high degree of representativeness, coordination, and trust between bargaining parties. These conditions are more likely to exist in advanced economies in which social dialogue has deep roots (for example, in northern European countries) than in emerging market and developing economies.

IMF ADVICE FOR EMERGING MARKET AND DEVELOPING ECONOMIES, 2005–16

52. In recent years, the IMF has placed increased emphasis on analysis of labor market issues as part of its attempt to nurture inclusive growth in economies. In 2011, IMF management set up a Jobs and Growth group to enhance its work on these topics. In its paper to the IMF Executive Board, the group noted that while many emerging market and developing economies had enjoyed fairly solid growth, the benefits of that growth had not always been equitably shared—a cause of concern to governments in many of these countries.

53. In addition to the work of the Jobs and Growth group, the IMF has conducted research in recent years into the adverse effects of excessive inequality and lack of gender equality on the macroeconomy. In the labor market, inequality is reflected in the creation of dual labor markets, through which some groups of workers are excluded from access to and benefits of decent jobs enjoyed by others. The IMF has started to operationalize this research; that is, to incorporate the findings into IMF advice at the country level.

54. In short, over the past few years, the IMF has made a concerted effort to better integrate efficiency and equity considerations into its advice to countries. This section describes how IMF advice on labor market issues has begun to reflect this integration.

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55. The task of cataloging IMF advice is very labor intensive. This note could not cover the full set of emerging market and developing economies so it studies a sample of countries, using the Morgan Stanley Capital International (MSCI) definitions of emerging and frontier markets. Table 1 lists the countries in these two groups and indicates the 20 emerging and 10 frontier markets covered. The MSCI definition of emerging markets includes some economies that are classified as advanced in terms of their per capita income (including in the IMF's *World Economic Outlook* classification); however, their labor markets share many characteristics with those of emerging markets and thus belong in this study. The sample does not contain countries with very low per capita incomes, so the findings cannot be generalized to such countries.

Table 1. MSCI Emerging and Frontier Market Countries
(Economies included in the sample are in ***bold italics***)

Emerging Markets			Frontier Markets		
Americas	Europe & MENA	Asia	Americas	Europe, CIS & MENA	Asia
Brazil	***Czech Rep.***	***China***	***Argentina***	Bahrain	***Bangladesh***
Chile	***Egypt***	***India***		Croatia	Pakistan
Colombia	***Greece***	***Indonesia***		Estonia	Sri Lanka
Mexico	***Hungary***	***Korea***		***Jordan***	***Vietnam***
Peru	***Poland***	***Malaysia***		Kazakhstan	
	Qatar	***Philippines***		***Kenya***	
	Russia	Taiwan POC		Kuwait	
	South Africa	***Thailand***		Lebanon	
	Turkey			Lithuania	
	UAE			Mauritius	
				Morocco	
				Nigeria	
				Oman	
				Romania	
				Serbia	
				Slovenia	
				Tunisia	
				WAEMU	

56. Text mining techniques were used to extract references to labor market institutions in Article IV Reports from 2005 through 2016. Then the extracts were reviewed and IMF policy advice was sifted out from routine descriptions of labor market developments.[28] The appendix provides a condensed version of the extracts, as well as five tables describing IMF advice on (1) unemployment

[28] A team of research analysts did the initial sifting of advice from descriptions. The authors of this paper read the sifted advice; when necessary, they consulted the relevant Article IV Reports to get the context for the advice. In a few cases, the advice was contained in program documents rather than in Article IV Reports.

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insurance, (2) employment protection legislation, (3) active labor market policies, (4) minimum wage, and (5) collective bargaining.

Advice on UI and EPL

57. The IMF advised about 20 percent of the countries on UI at some point over the period 2005–16, and 40 percent of countries on EPL (see Appendix Tables A1 and A2). The most common advice on UI was to set up a system or to extend benefits, while the most common advice on EPL was to lower generous severance payments. The trade-off between UI and EPL was mentioned in only a couple of cases. And while active labor market policies were recommended in about 25 percent of the countries, there was no mention that the extension of UI should be accompanied by such policies.

58. The advice to set up or extend the UI system was more common in higher-income emerging market economies than in other countries. Examples include Chile (2010, 2015), China (2015–16), Malaysia (2013, 2016), and Turkey (2007). UI was seen more as part of the necessary social safety net than as a facilitator of microflexibility;[29] hence, the discussion of UI was often bundled with advice on expanding social assistance (which was recommended in about half the countries) and was often part of a broader discussion of reform of the tax and benefit system. In some cases, the advice was not for expansion of social assistance but for better targeting (Hungary, 2011; Mexico, 2015) or for replacing fuel or other subsidies with cash transfers (Indonesia, 2012; Jordan, 2012).

59. The advice on EPL focused largely on reducing high severance payments, with some exceptions (for example, Mexico, 2012). Two reasons were commonly given as the motivation for IMF staff advice.[30] One was that doing so would enhance productivity through better reallocation of workers (Chile, 2009–15; Malaysia, 2012; Peru, 2006; Turkey, 2007). The other was that it would reduce informality and dualism in the labor markets (Chile, 2009–15; Indonesia, 2013; Morocco, 2011; Peru, 2006; Turkey, 2007) and would thus contribute to making growth more inclusive.

Advice on minimum wage

60. Advice on the minimum wage was pervasive: It was given in 70 percent of the country cases at least once over this period. As noted in the previous section, minimum wages (relative to median wages) tend to be higher in these economies than in advanced economies, and risks of adverse employment effects from this high level need to be taken seriously. Against this backdrop, IMF advice has been to lower the minimum wage relative to some benchmark or to limit the pace of

[29] In two cases—China and Malaysia—the expansion of UI was seen as part of an attempt to lower the current account surplus.

[30] Sometimes claims of other impacts (which are not totally persuasive, given evidence from the literature) were made, such as an increase in aggregate employment or an improvement in price competitiveness.

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increases to productivity growth or inflation targets.[31] Examples include Brazil (2013), Colombia (2011), Serbia (2013), and Turkey (2016). In recent years, discussion increased on using the minimum wage as a tool for equity and on the efficiency–equity trade-offs posed by changes in minimum wage (for example, the Philippines in 2016 and South Africa in 2016).

61. Only modest claims were made regarding the effect such changes would have on aggregate employment, consistent with the empirical evidence. The recommendation was motivated more by the likely effect on specific groups. In many cases, the advice was to differentiate minimum wages across types of workers or regions. For instance, the IMF recommended lower minimum wages for youth and low-skilled workers relative to others in Colombia (2015) and Hungary (2014), and lower minimum wages in some regions of Malaysia (2013) and Poland (2005–06).

Advice on collective bargaining

62. Advice on collecting bargaining has become more prevalent. Such advice was given in about 25 percent of the country cases, and the incidence appears to be growing. The two countries for which advice on collective bargaining was fairly intensive were Greece (2006, 2007, and 2013) and South Africa (2005–06, 2010–14, 2016), with Argentina (2016), Chile (2015), the Philippines (2014), Poland (2007), Romania (2012), and Serbia (2014) making up the other cases. In all these cases, the recommendation was to reduce the extent of centralization of collective bargaining.

63. As discussed in Blanchard and others (2013), in some euro area countries macroflexibility was needed to correct a large competitiveness problem at a fixed nominal exchange rate. In the absence of the option of using the exchange rate to ease the adjustment, the IMF recommended achieving wage reductions through national agreements among social partners. However, such agreements were difficult to achieve or did not take place, in some instances reflecting a lack of trust between social partners. In Greece, with its poor labor relations, no deal could be struck.

64. For South Africa, which is characterized by very high unemployment rates and extensive labor market duality, the advice in 2005–06 was to relax the extension principle "to allow small firms to negotiate agreements that reflect their own economic circumstances." In 2010, the country was in a recession, but wage settlements remained high and employment declined sharply. In staff's view, this showed that the "wage bargaining framework is not sufficiently flexible," and they urged changes in the framework "to allow companies to adjust more easily to economic fluctuations in a way that preserves jobs." Over 2011–16, staff repeatedly advised changing the sector-wide wage bargaining system to exempt small and medium-sized enterprises from the wage increases "to which the more productive and deeper-pocketed large firms agree." The IMF also called for a tripartite social accord, including wage restraint, in return for hiring commitments from industry.

[31] In one case (Bangladesh, 2013) an increase in the minimum wage in the garment industry, which the authorities instituted along with other protections in the aftermath of a major industrial accident, was welcomed by staff.

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CONCLUSIONS

65. Getting labor market policy right can play an important role in delivering inclusive growth; that is, growth with equity. This is especially true in emerging market and developing economies, where there is often much scope for scaling up and improving the design of labor market institutions and a strong need for more inclusive growth amid slowing productivity growth (Adler and others 2017) and high (or in some cases increasing) inequality (World Bank 2016).

66. This note has provided a critical review of the literature on the design of labor market institutions in emerging and developing market economies, and benchmarked the advice featured in IMF recommendations for 30 emerging market and frontier economies against the tentative conclusions from the literature. When set against the complexity of the issues involved, the advice is sound and consistent with the broad consensus in the literature, especially considering the fact that IMF recommendations are shaped not only by efficiency and equity objectives (which have been the focus of this note) but also by political economy, technical capacity, and fiscal sustainability constraints. The purpose and content of the advice has evolved over time, along with a growing recognition of the need for labor market and other institutions to promote more inclusive growth. Several issues are worth exploring in greater depth in considering how best to design policies:

- On unemployment insurance, one challenge is to go beyond generic advice tied only to strengthening social safety nets. It will be increasingly important to discuss the design features of UI systems and how those systems can be scaled up over time.

- On EPL, the focus has often been on the level of severance payments and advising that it be reduced. However, reducing uncertainty about the cost and duration of firing procedures might be more important than the level of payments. In the future, the stringency of EPL could be linked to the buildup of the benefit system: As the latter is put in place, EPL could be scaled back.

- On minimum wages, the welcome trend in recent advice is to pay attention to equity–efficiency trade-offs. Overall wages in many emerging and frontier countries are still very low, and developmental objectives should loom large in the minds of policymakers and advisors. When minimum wages are scaled down for efficiency reasons, the process could be systematically accompanied by alternatives to meet equity goals; for example, cash transfers or, where administrative capacity exists, income tax credits.

- On collective bargaining—a complex area in which more research is needed—it would be useful to develop a consistent view of policies that acknowledges that different collective bargaining systems can achieve efficiency and equity, and to focus on the detailed features needed for a given system to deliver in practice. In this area, as well as on other labor market policy issues, it is important to keep in step with evolving academic and policy knowledge.

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APPENDIX

This appendix lists the advice extracted through text mining techniques for each of the countries and policy areas covered in the note. Capitalized words correspond to key word searches. Text in the "Article IV Extract" column corresponds to extracts (direct quotes) from Article IVs.

Table A1. Unemployment Benefits

Country	Year	Page	Article IV Extract
Chile	2009	27	Staff also noted scope to improve the balance between security and flexibility in the labor market. The authorities and staff agreed that future efforts could focus on further promoting formal employment, by introducing reforms to the UNEMPLOYMENT INSURANCE system that help lower SEVERANCE PAYMENTS, as well as by easing some restrictions on contracts.
Chile	2010	13	Staff agreed with the authorities that replacing the current high SEVERANCE PAYMENT system with a more comprehensive UNEMPLOYMENT INSURANCE scheme could help increase labor market mobility and encourage greater investment in education and on-the-job training.
Chile	2015	21	Staff welcomed recent changes in UNEMPLOYMENT INSURANCE (which have increased the amount and duration of the benefits from a relatively low base, and linked them to mandatory training), and the efforts to improve skill training programs for youth and women outside of the labor force.
China	2016	30	Increasing on-budget support for consumption should include raising pensions, SOCIAL ASSISTANCE, education and health spending, UNEMPLOYMENT BENEFITS and providing restructuring funds, while cutting minimum social security contributions and raising SOE dividend payments. Increases in social benefits should be targeted to ensure progressivity.
Korea	2015	25	Reducing labor market rigidities: This entails addressing gaps in legal protection for regular and non-regular workers, moving to performance- rather than seniority-based wages, reducing incentives for forcing early retirement, and improving UNEMPLOYMENT INSURANCE.
Korea	2016	20	Fiscal support, including UNEMPLOYMENT INSURANCE benefits, retraining opportunities, and job-search facilities, could assist workers affected by corporate restructuring or labor market reforms -- this would allow more equitable outcomes and increase the likelihood of developing consensus for structural reforms.

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Malaysia	2011	20	Consideration could also be given to introducing an UNEMPLOYMENT INSURANCE scheme that could be mainly funded by employers and employees to avoid burdening the public purse.
Malaysia	2012	16	The authorities could consider other measures to strengthen inclusiveness, such as introducing an UNEMPLOYMENT INSURANCE scheme funded by employers and employees; improving the targeting of CASH TRANSFER programs; and making them conditional on access to education and health care.
Malaysia	2013	25	Staff recommended the introduction of UNEMPLOYMENT INSURANCE, which the authorities are studying, and which would further strengthen the safety net and reduce precautionary savings.
Malaysia	2016	90	It would be useful to continue to improve social protection and social insurance institutions, including the introduction of an UNEMPLOYMENT INSURANCE system, increase private investment, including in physical infrastructure; and address labor-force skill mismatches and rigidities in the labor market. Consistent with the authorities' intentions, stronger SOCIAL SAFETY NETS and efforts to further boost private investment would help to further moderate the current account surplus.
Turkey	2007	34	Staff suggestions to increase labor market flexibility and boost productivity include lower SEVERANCE PAYMENTS, while loosening eligibility requirements for UNEMPLOYMENT INSURANCE.

Table A2. Employment Protection Legislation

Country	Year	Page	Article IV Extract
Chile	2005	23	In the labor area, several studies have shown that Chile exhibits significant labor market inflexibility, in part as a result of still widespread practices of inflation-indexed wage contracts, binding MINIMUM WAGEs for low-skilled workers, high SEVERANCE PAYMENTS, and cumbersome rules for worker dismissal. However, the authorities were not considering any new specific initiatives in this area in the near future.
Chile	2009	27	The authorities and staff agreed that future efforts could focus on further promoting formal employment, by introducing reforms to the UNEMPLOYMENT INSURANCE system that help lower SEVERANCE PAYMENTS, as well as by easing some restrictions on contracts.
Chile	2010	14	Replacing the current high SEVERANCE PAYMENT system with a more comprehensive UNEMPLOYMENT INSURANCE scheme, for example, would increase labor mobility and encourage greater investment in education and on-the-job training.

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Chile	2012	15	In line with OECD recommendations, staff suggested that labor market efficiency could be enhanced by moving away from the system of high SEVERANCE PAYMENTS for workers, increasing the flexibility of working hours, and improving the efficiency of training programs.
Chile	2013	24	In line with OECD recommendations, a reconsideration of the relatively high SEVERANCE PAYMENTS and the rigid working hours, and strengthened training programs could help ensure efficient labor allocation.
Chile	2014	39	Structural Reforms: i) Establishing a reform agenda for boosting productivity growth; ii) Improving labor market efficiency and flexibility, including by streamlining the high MINIMUM WAGE and SEVERANCE PAYMENTS, increasing the flexibility of working hours, raising (female and youth)labor participation, and improving the efficiency of training programs;
Czech Republic	2006	3	A high tax wedge and generous entitlements discourage job search, and strict EMPLOYMENT PROTECTION hampers job creation.
Greece	2005	15	There is clearly scope to improve the Greek business climate, particularly by streamlining business establishment procedures and lowering hiring and firing costs, notably strong EMPLOYMENT PROTECTION arrangements.
Greece	2006	20	Further initiatives in the labor market, which has seen less reform, include relaxation of strong EMPLOYMENT PROTECTION legislation and decentralization of the bargaining system.
Greece	2007	21	The Greek labor market remains relatively rigid by international comparison. Reform should focus on enhancing the flexibility of the wage setting system and easing the restrictiveness of EMPLOYMENT PROTECTION legislation.
Greece	2009	32	Greece can also facilitate more part-time work to boost participation of youths and women in the labor force, and ease EMPLOYMENT PROTECTION legislation.
Indonesia	2007	34	The authorities should now focus on, modifications in labor regulations to alleviate the burden of SEVERANCE PAYMENTS on employment generation and facilitating public private partnerships in infrastructure (in addition to more budgetary spending) while ensuring that they are adequately prepared and assessed.
Indonesia	2013	25	Reducing the rigidity of Indonesia's labor regulations, particularly with respect to SEVERANCE PAY, would improve Indonesia's competitiveness and generate jobs to absorb a large pool of underemployed workers (notably in the agricultural sector), supported by higher social spending.

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Korea	2009	27	Past staff advice to reduce EMPLOYMENT PROTECTION for regular workers and expand social protection of non-regular workers is still appropriate. More LABOR MARKET FLEXIBILITY would facilitate a reallocation of labor from the tradables to the nontradables sector, while better social protection would strengthen domestic demand by reducing precautionary savings. Moreover, increasing labor market participation of women, the old, and the young would help offset the projected fall in total factor productivity associated with a shift of economic activity to the less productive nontradables sector.
Korea	2010	22	As previously recommended, there is scope to reduce the high level of EMPLOYMENT PROTECTION for regular workers to raise LABOR MARKET FLEXIBILITY and employment growth. However, any easing of EMPLOYMENT PROTECTION should be accompanied by an expansion in the SOCIAL SAFETY NET for both regular and nonregular workers to provide some income protection in case of layoffs.
Korea	2012	24	Reducing labor market duality would entail relaxing EMPLOYMENT PROTECTION for regular workers, to reduce the incentives for firms to hire non-regular workers.
Korea	2013	17	Efforts to reduce labor market duality should be stepped up. Broadening the access to training opportunities and improving social coverage for non-regular workers would raise productivity and reduce precautionary saving. To preserve overall employment, some changes in regular workers' contracts may be needed, including moving to performance rather than seniority based wage, reducing the relatively high degree of EMPLOYMENT PROTECTION, and accelerating the shift from mandatory retirement allowance to corporate pension schemes with defined contributions or defined benefits.
Mexico	2012	16	The labor reform bill would overhaul labor laws dating back to 1970. Provisions to streamline the settlement of labor lawsuits and to limit compensation for unjustified dismissals to one year of salary. These provisions would simplify the current lengthy dispute resolution process (which can hold up SEVERANCE PAY for several years) and provide more legal certainty.
Peru	2006	34	With three fourths of workers employed in the informal sector, reducing informality in the labor market is imperative. A comprehensive reform of labor market legislation should aim at lowering high SEVERANCE PAYMENTS, better aligning non-wage benefits with job tenure, and removing legal restrictions that

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			prevent dismissals for economic, technological, and structural reasons.
Philippines	2004	14	While supporting the authorities' goal of improving public service delivery, staff argued that awarding generous SEVERANCE PAYMENTS to those already near retirement would reduce the possible gains to the budget.
Philippines	2009	23	Strengthen LABOR MARKET FLEXIBILITY: Liberalize the use of fixed-term contracts, gradually reducing or phasing out MINIMUM WAGEs while strengthening SOCIAL SAFETY NETs, and reducing redundancy notice periods and SEVERANCE PAY.
Poland	2007	21	As a simple thought experiment based on the panel econometric results, if Poland moved instantaneously to the position of Ireland for the key institutional variables-tax wedge, disability benefits, government wage bill, product market regulation, EMPLOYMENT PROTECTION legislation, and WAGE BARGAINING coordination/ centralization-the private sector employment rate would climb by 9½ percentage points over three years, erasing 60 percent of the difference between the two countries in this variable.
Serbia	2013	13	Staff urged … delinking SEVERANCE PAYMENTS from lifetime employment, and relaxing restrictions on the separation process, which in turn would improve incentives for hiring.
Serbia	2014	21	The reform limits SEVERANCE PAYMENTS by linking them to service with the current employer rather than life-time employment [and] clarifies and simplifies separation rules. Staff welcomed these changes.
Tunisia	2015	37	Staff urged the authorities to speed up completion of the National Employment Strategy [through] reviewing the rigid hiring-FIRING policies, worker protection system and public/private sector compensation.
Turkey	2007	34	Staff suggestions to increase labor market flexibility and boost productivity include: lower SEVERANCE PAYMENTS, while loosening eligibility requirements for UNEMPLOYMENT INSURANCE;
Turkey	2010	8	Turkey's SEVERANCE PAY scheme is among the most generous in the OECD (one month per year of tenure), while its regulations on short-term contracts are the most restrictive. As a result, jobs have been squeezed from the formal to the informal sector or job creation has been discouraged altogether.
Turkey	2011	30	To encourage new employment and job mobility within the formal sector, the mission urged lowering restrictions on temporary and part-time work, and replacing the current ex post SEVERANCE PAY with a pre-funded, lower-cost insurance scheme.

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Turkey	2016	20	Specifically, reforms aimed at increasing funding in the private pension and the SEVERANCE PAY systems, while maintaining a tight fiscal stance, should be implemented swiftly. These reforms could raise the private saving rate (IMF 2016b), especially as the current pay-as-you-go PENSION SYSTEM remains generous by international standards.

Table A3. Active Labor Market Policies

Country	Year	Page	Article IV Extract
China	2016	30	Key reforms include: expanding social security and improving the portability of all types of benefits, liberalizing residency restrictions, and improving ACTIVE LABOR MARKET POLICIES.
Czech Republic	2007	23	Higher labor market participation and lower structural unemployment could be achieved through better targeted ACTIVE LABOR MARKET POLICIES, less rigid regulations regarding hiring and dismissals, and an improved design of the tax-benefit system. More flexible labor markets would also help position the Czech economy for a smoother path to euro adoption.
Czech Republic	2013	14	Higher labor participation, LABOR MARKET FLEXIBILITY, and active labor policies are important to increase potential growth and avoid long-term negative impact of unemployment. In order to avoid long-term negative impact of unemployment, ACTIVE LABOR MARKET POLICIES providing information, counseling and retraining are important.
Greece	2007	18	Staff urged the authorities to review EMPLOYMENT PROTECTION legislation, especially on temporary employment. Staff also recommended strengthening ACTIVE LABOR MARKET POLICIES to increase labor mobility.
Hungary	2010	12	Narrow the scope of ACTIVE LABOR MARKET POLICIES to groups most disadvantaged in the labor market.
Hungary	2014	19	Renewed structural reform momentum is needed to remove obstacles to growth. Past reforms to boost labor demand and supply have borne fruit, but further steps are required. Consideration should be given to boosting labor demand by differentiating the MINIMUM WAGE across different groups and linking future increases to productivity growth; and reducing labor market skills mismatches by strengthening the training component of ACTIVE LABOR MARKET POLICIES (see accompanying Selected Issues Paper).

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Hungary	2015	11	Staff thus recommended a menu of options for measures that could be adopted over 2015–20 (text table), including: more efficient social welfare system based on targeted, conditional transfers linked to revamped ACTIVE LABOR MARKET POLICIES that focus on individualized skills-training and job-search assistance.
Hungary	2016	20	In addition, there is a need to upgrade labor force skills, address skill mismatches, and increase employment of low-skilled. To this end, staff argued that ACTIVE LABOR MARKET POLICIES should entail strengthened training components and enhanced job-matching services, while tax-benefit systems should be reformed (Annex IV).
Jordan	2012	21	Lowering the current high level of unemployment will require enhanced competitiveness in the economy, and adoption of ACTIVE LABOR MARKET POLICIES that seek, through market-friendly programs such as vocational training, job matching services, and support for youth start-ups, to better position Jordanians in local and international labor markets.
Jordan	2014	22	The NES suggests that various factors have led to weak labor market indicators for females, specifically: employers' perceptions; limited access to information on job opportunities; the lack of targeted ACTIVE LABOR MARKET POLICIES for females; the lack of maternity benefits in the private sector; and the absence of affordable and dependable childcare. Addressing such constraints could go a long way to unlocking the employment potential of Jordanian women.
Poland	2011	17	With limited resources for spending on ACTIVE LABOR MARKET POLICIES, the efficiency and targeting of existing measures could be reviewed.
Poland	2016	37	ACTIVE LABOR MARKET POLICIES to improve job searching efficiency across regions combined with policies to reduce skill mismatches-including by better aligning education and training curricular with employer needs-would facilitate labor mobility across sectors and regions, and help lower high structural unemployment in the east.
Russia	2016	27	Increasing mobility and reducing skills mismatches by improving education quality and vocational training, increasing the coordination between employers and training institutes, and strengthening ACTIVE LABOR MARKET POLICIES should increase labor productivity.

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South Africa	2012	31	In the short run, employment can also be supported through ACTIVE LABOR MARKET POLICY (ALMP) measures. These could include temporary youth wage subsidies, transport subsidies for job seekers, and other schemes to provide working experience and on-the-job training. Staff noted such schemes should be carefully designed to prevent abuse and create net employment, with spending in this area tightly controlled given the fiscal cost of such schemes.

Table A4. Minimum Wage

Country	**Year**	**Page**	**Article IV Extract**
Bangladesh	2013	24	The imminent revision in garment sector MINIMUM WAGES [is] welcome.
Brazil	2013	36	Revising the MINIMUM WAGE indexation mechanism, together with the efforts to rebalance demand away from consumption, are essential to keep unit labor costs in check and prevent further erosion in competitiveness; this would contribute to bolster the return on capital (particularly in manufacturing) and improve incentives for investment.
Brazil	2014	24	Revising the indexation of certain benefits, including pensions, to the MINIMUM WAGE would also help raise public saving.
Brazil	2016	27	Severing the automatic link between benefit payments and the MINIMUM WAGE is advisable, as would be limiting MINIMUM WAGE increases to cost of living adjustments. The moderation of the MINIMUM WAGE indexation rule, proposed earlier on fiscal grounds, would also contribute to restoring youth employment.
Chile	2005	23	In the labor area, several studies have shown that Chile exhibits significant labor market inflexibility, in part as a result of still widespread practices of inflation-indexed wage contracts, binding MINIMUM WAGEs for low-skilled workers, high SEVERANCE PAYMENTS, and cumbersome rules for worker dismissal. However, the authorities were not considering any new specific initiatives in this area in the near future.
Chile	2006	26	Staff urges the authorities to take bold action in this area, to help address the still high unemployment rate-especially among the young-and improve labor force participation. In particular, reforms should aim at introducing more flexibility in working hours, allowing longer fixed-term contracts, and avoiding too rapid increases in the MINIMUM WAGE rather than subsidizing them.

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Chile	2010	13	Staff also noted that relatively high MINIMUM WAGEs in Chile—45 percent of the average wage compared to the OECD average of 40 percent—could increase youth unemployment and contribute to the growth of the informal sector.
Chile	2012	17	Chile's relatively high ratio of minimum-to-average wages could hinder employment growth and contribute to growth of the informal sector. To contain this risk, MINIMUM WAGE increases should be consistent with productivity growth.
Chile	2014	39	Improve labor market efficiency and flexibility, including by streamlining the high MINIMUM WAGE
Colombia	2005	10	This high level of structural unemployment reflects several factors, including high nonwage labor costs, a relatively high MINIMUM WAGE, labor market regulations, and an excess supply of lower-skilled workers.
Colombia	2008	17	In addition, an adverse outcome from MINIMUM WAGE negotiations could increase inflationary pressures.
Colombia	2011	30	Staff recommended a sweeping reform of labor tax legislation as part of the broader reform of the tax system and adopting mechanisms to ensure that MINIMUM WAGE adjustments do not exceed target inflation. Staff also noted that the current tax system and sharp rise of MINIMUM WAGEs was hurting competitiveness.
Colombia	2012	49	Labor market studies have also identified high non-wage costs and the rapid real increases in the MINIMUM WAGE as main contributing factors to the high structural unemployment and informality, which in turn perpetuate a cycle of poverty (see 2011 Article IV Consultation). Finally, the tradition of linking the increase in monetary transfers—such as the minimum pension payment—to MINIMUM WAGE growth has, in practice, effectively reduced the resource envelope that could be dedicated to other redistributive initiatives. Colombia’s tradition of linking the increases in fiscal transfers to the growth in the MINIMUM WAGE could be dismantled.
Colombia	2014	37	While skill mismatches may play a role in the high rate of unemployment, very high labor costs are the main contributor to the large informal sector. In a recent survey, 30 percent of employers in Colombia reported having difficulty filling vacancies. 3 Yet, real increases in the MINIMUM WAGE outpaced productivity growth in the 1990s, spurring a movement from the formal to the informal sector. This trend particularly affected young and old workers, those with lower productivity, and those living in remote areas. The MINIMUM

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			WAGE remains a high relative to average value-added. For example, in mid-2013, the MINIMUM WAGE for a 19-year old worker or an apprentice stood at $310 per month, representing about 30 percent of value-added. In addition, non-wage costs constitute about 40 percent of total labor costs for the average worker, compounding the effect of the high MINIMUM WAGE on informal employment. The tax reform of 2012 lowered non-wage compulsory payments by eliminating health, training, and child care contributions, and may have contributed to reduce informality since mid-2013.
Colombia	2015	25	Colombia's poverty, inequality, youth unemployment, and informality are still elevated (Box 10). Labor market formalization has improved as a result of the 2012 tax reform, which lowered taxation on labor (see Selected Issues Paper). However, the high MINIMUM WAGE relative to the average wage hinders further formalization gains, particularly for youth and unskilled labor.
Czech Republic	2014	59	The MINIMUM WAGE should be increased annually in order to reflect the socio-economic environment and to raise it over time to 40 percent of the average wage.
Greece	2005	20	Further reforms are needed, however, to spur hiring and prevent job losses. These should include the relaxation of strong EMPLOYMENT PROTECTION legislation, greater opportunity for opting-out of aspects of the centrally agreed MINIMUM WAGEs, especially in sectors under stress.
Greece	2013	16	The labor market has traditionally suffered from a closed and inflexible system of COLLECTIVE BARGAINING, very high firing costs (severance payments and redundancy notification periods), a high national MINIMUM WAGE relative to competitors, and high non-wage labor costs.
Hungary	2005	31	Since the sizable increases in the MINIMUM WAGE in 2001-02 ill served the goal of employment generation, further increases should be contained.
Hungary	2011	71	The government has introduced a new flat tax rate system in 2011. The MINIMUM WAGE has been increased on a one-off basis to compensate for the tax hike for low-income earners. At the same time, and to preserve employment, enterprises are compensated for the labor cost increase resulting from the increased MINIMUM WAGE. The MINIMUM WAGE hike, coupled with the compensatory scheme, should also reduce prevalent tax evasion consisting of only declaring the MINIMUM WAGE income.

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Hungary	2014	19	Consideration should be given to boosting labor demand by differentiating the MINIMUM WAGE across different groups and linking future increases to productivity growth.
Hungary	2016	59	A number of measures could be considered to further promote employment in vulnerable groups, including introducing differentiated MINIMUM WAGEs, broadening the definition of eligible skilled workers from the currently narrowly defined group.
India	2010	45	The cost of expanding NREGA in those states with relatively low penetration to the same level the program has attained in the most implemented states would be around 0.8 percent of GDP. Implementation on this broader scale would thus more than double the current cost of the program. Tying wage rates to MINIMUM WAGEs could also raise costs.
Indonesia	2005	27	The mission supported the recently established regional tripartite councils, which bring together employers, employees, and the government, and are designed to address concerns of both labor and employers and set the MINIMUM WAGE. The mission encouraged the use of this framework to resolve other labor-related issues, such as SEVERANCE PAY levels and outsourcing, with a view to making the labor market more flexible and increase competitiveness vis-Ã -vis the region.
Indonesia	2013	25	Reducing the rigidity of Indonesia's labor regulations, particularly with respect to SEVERANCE PAY, would improve Indonesia's competitiveness and generate jobs to absorb a large pool of underemployed workers (notably in the agricultural sector), supported by higher social spending. Aligning wage increases with productivity growth and redefining the MINIMUM WAGE as a safety net instrument rather than a tool for COLLECTIVE BARGAINING would help on this front as well. The growth in labor costs in manufacturing has outpaced productivity gains, leading to rising unit labor costs and a move away from labor-intensive manufacturing sectors. Factors behind the increase in unit labor costs have been high MINIMUM WAGE levels relative to average wages, frequent adjustments to MINIMUM WAGEs themselves, and indexation of most wage contracts to MINIMUM WAGE increases.
Indonesia	2014	26	Moving away from annual negotiations of MINIMUM WAGEs would also reduce uncertainty to employers and possibly spur more hiring.

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Jordan	2012	22	Ensure that any revisions to the public sector compensation package or the structure of MINIMUM WAGEs do not distort incentives for private sector employment.
Morocco	2011	14	Further reforms aimed at reducing MINIMUM WAGEs and hiring costs are critical to reduce youth unemployment (Selected Issues Paper on Unemployment).
Mexico	2014	10	Staff noted that risks to the inflation outlook are mostly on the upside. Slack in the economy may diminish faster than expected. In addition, an eventual increase in the MINIMUM WAGE could affect wages more broadly, putting upward pressure on prices.
Malaysia	2011	21	The key question is whether the role [of the MINIMUM WAGE] in supporting wages of low-skilled workers is offset by dis-employment effects, and will depend on the rate that is set. Moreover, implementation will be challenging in an economy with porous borders and where workers can easily migrate from the formal to informal sector. A MINIMUM WAGE policy would have to be carefully designed to address these concerns.
Malaysia	2012	16	A MINIMUM WAGE has been introduced with effect from January 2013, aimed at boosting wages of low-skilled workers and enhancing productivity. Preliminary analyses suggest that it is likely to have a limited impact on inflation and unemployment (Box 1), and should therefore help improve the incomes of the poor. The authorities could however consider whether highly affected firms should be granted more time to adjust, and whether further allowance should be made for regional wage dispersion.
Peru	2016	15	There could be some pressure [on inflation] from the recent 13 percent increase in the national MINIMUM WAGE; however, as discussed with the BCRP, the pass-through of minimum wage increases to consumer price inflation is uncertain. Staff expects inflation to be within the authorities' target range in the medium term.
Philippines	2009	23	Strengthen LABOR MARKET FLEXIBILITY: Liberalize the use of fixed-term contracts, gradually reducing or phasing out MINIMUM WAGEs while strengthening SOCIAL SAFETY NETs, and reducing redundancy notice periods and SEVERANCE PAY.
Philippines	2016	18	The exemption for MINIMUM WAGE earners effectively exempts a large share of the labor force. It also creates a vertical inequity, as those with wages earning slightly higher than the MINIMUM WAGE are taxed on their full income (less

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			the personal allowance), while those earning the MINIMUM WAGE are untaxed. The 13th month salary exemption is also highly regressive.
Poland	2005	24	Although the OECD ranks labor market regulation in Poland relatively favorably, addressing the low employment rate will require exemplary regulatory conditions. In this vein, freezing the MINIMUM WAGE to make it less binding for low-skill workers, differentiating the MINIMUM WAGE across regions and for young workers; and eliminating remaining impediments to job creation (particularly undue regulation of regular labor contracts) would help increase labor demand.
Poland	2006	22	Better targeting out-of-work benefits and differentiating MINIMUM WAGEs regionally would increase incentives to work.
Romania	2016	18	Staff recommended that the pace of future MINIMUM WAGE increases be moderate and balance social considerations with competitiveness, productivity growth, and employment prospects.
Serbia	2013	14	Staff also cautioned against MINIMUM WAGE increases that outpace productivity growth and consequently exacerbate the already high youth unemployment (already at 51 percent).
Thailand	2012	29	The government's program aims at rebalancing income distribution through higher MINIMUM WAGEs and rice prices. Narrowing the income gap is a laudable objective, but it needs to be accompanied by higher labor productivity to maintain competitiveness. Hence, the gradual approach to implementing the MINIMUM WAGE policy is appropriate.
Thailand	2013	70	The implementation of the nationwide MINIMUM WAGE hikes could continue to induce the enhancement of labor productivity and firms' production process.
Thailand	2015	61	Incentives to hire newcomers to the formal labor market may be enhanced by temporary tax breaks or MINIMUM WAGE waivers.
Turkey	2007	34	Ease—or at least differentiate regionally—the real minimum wage (which exceeds 150 percent of regional per capita income in the poorer provinces);
Turkey	2010	33	Reducing dependence on external savings requires rebuilding competitiveness and moderating demand for energy imports. Better aligning Turkey's productivity-adjusted employment costs with those of regional peers would foster formal-sector jobs and reduce the import content of production. Doing so requires lowering the MINIMUM WAGE (especially in low-

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			income regions), scaling back severance benefits, and allowing more flexible work practices.
Turkey	2011	33	MINIMUM WAGEs in the formal sector should be brought into line with peer countries, restrictions on flexible work arrangements should be relaxed, and a benefit scheme cushioning unemployment spells—rather than discouraging job mobility—should be introduced.
Turkey	2016	15	In January 2016, the government raised the net MINIMUM WAGE by 30 percent, fulfilling an electoral promise. This increase poses challenges for the labor markets, competitiveness, and the fiscal balance (Box 3). The authorities should pursue a prudent MINIMUM WAGE policy and help integrate refugees into the labor market. Increasing the MINIMUM WAGE faster than productivity is growing could hinder competitiveness and long-term growth prospects, and foster informality. For this year, the government support will ameliorate the impact on labor costs-although a more focused government support could have reduced the fiscal costs. For the future, it will be important to contain increases in the MINIMUM WAGE at or below programmed inflation.
South Africa	2006	25	Staff suggested that in setting MINIMUM WAGEs due account be taken of their effect on employment.
South Africa	2007	22	Staff recommended that adjustments in officially determined MINIMUM WAGEs and in public sector wages (the latter owing to its possible impact on private wage settlements) take into account their potential effect on employment.
South Africa	2011	22	While cross-country comparisons are always difficult, it does seem that the wages in manufacturing and the ratio of the MINIMUM WAGE to average output are comparatively high in South Africa (Appendix III and Zhan, 2011).
South Africa	2012	27	Labor market arrangements have set entry-level wages above the productivity of inexperienced workers with little marketable skills, including through relatively high MINIMUM WAGEs. The struggle for dividing rents between highly concentrated, oligopolistic firms and strong and politically influential labor unions has resulted in large economic losses associated with frequent labor strikes.
South Africa	2013	54	A national MINIMUM WAGE, as currently proposed by Cosatu, could further slow job creation; the issue of a minimum household income needs to be addressed through social transfers (CDE, 2013).

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South Africa	2014	27	The proposal to introduce a national MINIMUM WAGE to lessen income inequality should be carefully studied, as the average sectoral MINIMUM WAGE in South Africa is 62 percent of the average formal wage, compared to the 37 percent OECD average, and without lower sub-minima for younger workers as in many OECD countries. Hence, depending on its level and formulation, a national MINIMUM WAGE may increase unemployment, especially for lower-skilled workers.
South Africa	2016	31	The proposed national MINIMUM WAGE could help reduce inequality, though depending on its level and modality, risks causing job losses, especially among the less-skilled, young, and SME workers. Ensuring that the proposed national MINIMUM WAGE is designed so as not to undermine job creation and the goal of reducing income inequality is important.
Vietnam	2007	20	The indexation of public wages and pensions to the common MINIMUM WAGE should be discontinued.

Table A5. Collective Bargaining

Country	**Year**	**Page**	**Article IV Extract**
Argentina	2016	20	Core inflation continued to decline and reached 1½ percent (m/m) in September, consistent with about 20 percent annual rate. However, collective WAGE BARGAINING is still likely to inject a backward-looking element into the determination of nominal wages, and this nominal inertia is expected to slow the pace at which inflation falls. Persistently high inflation and inflation expectations have added to nominal inertia with a wage setting system that is characterized by extensive sectoral WAGE BARGAINING and a de-facto high level of wage indexation, despite the lack of formal backward indexation.
Chile	2015	21	It is particularly important that the reform maintains COLLECTIVE BARGAINING at the firm level and introduces more flexible work arrangements within the COLLECTIVE BARGAINING process (independently of the level of unionization within the firm). Protecting workers' right to strike should be balanced by clearly defining the range of "minimum services" that are guaranteed in case of strikes while remaining mindful of the effects of the reform on small firms.
Greece	2006	6	The external current account deficit widened. Strong domestic demand, supported by credit growth, has led to inflationary

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			pressures, while a centralized WAGE BARGAINING system has delivered higher unit labor cost growth than elsewhere in the euro area. The cumulative wage increase of over 11 percent in the 2006-07 two-year private sector wage settlement continued this trend. Noting that centralized COLLECTIVE BARGAINING agreements (including MINIMUM WAGEs) resulted in somewhat high (relative to productivity) MINIMUM WAGEs and a compressed wage scale (Figure 8), the mission argued a more decentralized system would be beneficial. Banks have been attempting to decentralize bargaining in their sector, but face stiff union resistance. The mission also argued for easing EMPLOYMENT PROTECTION legislation to encourage hiring.
Greece	2007	18	COLLECTIVE BARGAINING appear to be following the same pattern, with adverse implications for preserving international cost competitiveness. The authorities explained that a reform of the COLLECTIVE BARGAINING system is not on their agenda as social consensus would be difficult to obtain simultaneously with consensus on PENSION REFORM.
Greece	2013	16	The labor market has traditionally suffered from a closed and inflexible system of COLLECTIVE BARGAINING, very high firing costs (severance payments and redundancy notification periods), a high national MINIMUM WAGE relative to competitors, and high non-wage labor costs. Structural reforms were projected to start working their way through the economy relatively fast and offset the impact of further tightening, but projected gains did not materialize. Deregulation and privatization were expected to turn around expectations, and boost investments to exploit new profit opportunities. Income policies (reductions in public wages and changes to COLLECTIVE BARGAINING framework) were expected to improve cost competitiveness, which, together with pro-competition structural reforms, would reduce relative prices over time, encouraging strong export response. But these projections failed to materialize, mainly because the critical mass of structural reforms were not achieved, but also because transmission lags to growth proved longer than expected.
Philippines	2014	7	Inflation rose to 4 percent late in the year on pass through of the weaker peso, typhoon-related disruptions to food production, increases in rice prices and higher electricity prices due to maintenance shutdowns, and reached 4½ percent in May. These supply-side pressures are likely to be larger and more persistent in

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			the context of accommodative policies and a regionally centralized WAGE BARGAINING framework.
Poland	2007	21	As a simple thought experiment based on the panel econometric results, if Poland moved instantaneously to the position of Ireland for the key institutional variables—tax wedge, disability benefits, government wage bill, product market regulation, EMPLOYMENT PROTECTION legislation, and WAGE BARGAINING coordination/centralization—the private sector employment rate would climb by 9½ percentage points over three years, erasing 60 percent of the difference between the two countries in this variable.
Romania	2006	31	Staff urged the authorities to further amend labor market legislation to increase employers’ representation in the Economic and Social Council, and eliminate the obligatory nature of COLLECTIVE WAGE contracts for non-signatory parties.
Romania	2012	33	It is important to ensure that the new Labor Code and Social Dialogue Law are consistent with core ILO conventions, while efforts to undo the progress made should be firmly resisted.
Serbia	2014	21	The reform extends the maximum length of temporary contracts from one year to two years and tightens the rules for extensions of COLLECTIVE AGREEMENTS to all firms in the sector. Staff welcomed these changes.
South Africa	2005	8	On structural reforms, staff supported current initiatives to generate jobs, but considered that easing labor legislation—including by relaxing centralized COLLECTIVE BARGAINING and streamlining dismissal procedures—was critical to have a significant impact on unemployment. On the basis of international evidence showing that flexible labor markets are conducive to job creation, staff urged: (i) relaxing the "extension principle" in COLLECTIVE BARGAINING to allow small firms to negotiate agreements that reflect their own economic circumstances.
South Africa	2006	25	Centralized COLLECTIVE BARGAINING in some sectors, by which agreements between employers' representatives (usually large firms) and unions are "extended" to other firms in the sector, prevents smaller firms from negotiating agreements that reflect their own circumstances. The magnitude of the adverse impact of this practice on employment deserves further study.
South Africa	2010	22	Changes to the WAGE BARGAINING framework seem imperative. South Africa's labor legislation provides important and necessary protections for workers, but the large decline in employment during the recession suggests that some hard choices must now be confronted. Accordingly, a closer look at the bargaining framework

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			so that it encourages employers and employees to conclude more flexible wage contracts could help. Such provisions should allow companies to adjust more easily to economic fluctuations in a way that preserves jobs.
South Africa	2011	23	Staff saw merit in the proposal in the NGP to moderate economy-wide wage growth. One way to operationalize this would be through an accord between government, employers and trade unions to limit real wage increases to 1 to 2 percent for the next several years. And if this is not feasible, an alternative approach is to introduce changes to the sector-wide WAGE BARGAINING system so that it takes more account of the limited ability of small and medium size enterprises to abide by the sector-wide wage agreements to which the more productive and deeper-pocketed large firms agree.
South Africa	2012	28	A more flexible WAGE BARGAINING mechanism, for example for small, and medium enterprises (SMEs) or newly created businesses, as well as more flexible labor laws and regulations are essential to improve the business environment and increase employment opportunities, especially for newcomers with limited skills.
South Africa	2013	24	Limiting the practice of extending COLLECTIVE BARGAINING outcomes to firms that did not participate in the bargaining—especially SMEs—would increase wage flexibility and reduce barriers for entry for SMEs. South Africa's WAGE BARGAINING framework contributes to real wage outcomes that appear to have little sensitivity to economic conditions, and, in addition, legal provisions on dismissal, in practice, appear to make employers reluctant to take on new workers. Real wage growth has outpaced productivity growth, even during the 2008-/09 crisis when real GDP fell. Given South Africa's fairly high costs of living, even for poor households, workers' demands for higher wages are understandable. Even more so when considering that a single income earner often supports eight or more relatives. However, firms have responded by investing in labor saving capital and have been reluctant to hire. In addition, the mandatory extension of COLLECTIVE BARGAINING agreements makes it difficult for smaller firms. More generally, unemployed outsiders need to gain a voice in WAGE BARGAINING, and higher labor force participation would reduce the burden on those gainfully employed to provide for others that do not have a wage income.

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South Africa	2014	28	Simultaneous labor market reforms—increasing the influence of outsiders in wage setting, exempting SMEs from the extension of COLLECTIVE BARGAINING outcomes, and reducing firing costs, as recommended by the OECD—will limit job losses from lower profit margins and facilitate new firms' entry. These reforms could be pursued as part of a social bargain including wage restraint in return for industry's hiring commitments, and government's providing better quality education and training, and targeted transport subsidies. The role of the government is critical in ensuring that the interests of outsiders, the unemployed and small firms, are represented in the bargain. All these efforts should provide job opportunities, jumpstarting a virtuous cycle of growth, more jobs, and lower inequality.
South Africa	2016	34	Research shows that reforms that increase wage flexibility are particularly important in bad times as they offer firms channels other than retrenchments to cut labor costs. Therefore, the introduction of the proposed national MINIMUM WAGE should be accompanied by reforms that increase wage flexibility, including exempting SMEs from COLLECTIVE BARGAINING outcomes, and the introduction of contracts where workers gradually accumulate benefits and job security.

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