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Job creation or decent work: the IMF and a false choice

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As the World Bank's annual **Doing Business Report** approaches its 10th birthday review, it is arousing as much controversy as ever.

Already the Bank has dropped the **Employing Workers Indicator** following protests from the International Labour Organisation, among others, that it encouraged lower labour standards.

Yet the **International Monetary Fund** has recently published two working papers that present even worse policy reforms as being necessary to create jobs.

Here **Conor Cradden** challenges their data sources and methodologies, and demands a more serious approach to reconciling job creation with decent work.

Introduction

This article comments on two IMF working papers by Lorenzo E. Bernal-Verdugo, Davide Furceri, and Dominique Guillaume:

- Labor Market Flexibility and Unemployment: New Empirical Evidence of Static and Dynamic Effects (IMF Working Paper WP/12/64)
- Crises, Labor Market Policy, and Unemployment (IMF Working Paper WP/12/65)

The two papers were published as part a working paper series designed to make research by individual International Monetary Fund (IMF) staff members available to a wide academic audience. As such they do not represent official IMF policy positions but merely present the research of the authors, only two of whom are in fact IMF employees (Bernal-Verdugo is a PhD student at the University of Chicago).

Nevertheless, the IMF is an enormously influential institution, and as such has a duty to ensure that research published under its name meets standards that the public is entitled to expect. These papers fail that test. On the basis of misnamed indicators of dubious relevance to the task in hand, they perpetuate the long-discredited idea that unemployment can be solved simply by removing worker protections and giving employers unilateral control over wage-setting.

Dubious sources, dubious methods

The papers present two exercises in number-crunching that look for correlations between different types of labour market policy and levels of unemployment. The authors claim not only that the presence of flexible labour market institutions reduces the level of unemployment in all circumstances, but also that flexibility means that financial crisis-induced unemployment falls more rapidly once recovery begins. The authors claim: “Among the different labor market flexibility indicators analyzed, hiring and firing regulations and hiring costs are found to have the strongest effect.” (WP 64, p.1).

As is usual with this type of work, when the authors talk about labour market ‘flexibility’ or ‘rigidity’ they are referring directly not to the presence or absence of any particular policy or any particular type of institutional structure, but to a number, an indicator of labour market flexibility. The indicators of flexibility the authors use are in turn taken from the Economic Freedom of the World Report (EFWR) published by the Fraser Institute, a right-wing think tank based in Canada.

That report is not based on original research but brings together a collection of indicators produced by other organizations that, it is claimed, show the extent to which economic activity in any national setting is ‘free’. The data cover a wide range of policy areas including fiscal and monetary policy, property law, trade regulation, and labour and business regulation.

The indicators are drawn from multiple sources, but aside from an element dealing with military conscription, the labour market policy part of the report is based on the World Bank’s Employing Workers Indicators (EWI) and the World Economic Forum’s (WEF) Global Competitiveness Report (GCR).

The EWI has been discredited as encouraging lower labour standards and has been dropped from the Bank’s Doing Business Indicators. Yet the IMF authors uncritically accept the Fraser Institute’s operational definition of labour market flexibility and rigidity. Indeed, they do not even think it worthy of discussion, simply indicating that the EFWR is the source of their data and listing its different elements. Labour market ‘reform’ is defined as any policy or regulatory change that leads to a higher flexibility score based on the EFWR indicators.

On the definition they use, labour market ‘reform’ therefore involves the following:

- Widening the possibility of using fixed term contracts, even for permanent work
- Lowering the minimum wage
- Removing any and all regulation on hiring and firing
- Decentralising wage setting or possibly decollectivizing wage-setting or possibly both (these two ‘reforms’ are conflated)
- Removing restrictions on night work
- Reducing holiday entitlement

As if this was not bad enough in itself, the authors single out two indicators, hiring and firing regulations and hiring costs, as being particularly strongly correlated with lower levels of unemployment. This may well be the case, but we need to be clear about what is being correlated with what.

The first of these indicators is taken from the World Economic Forum’s Global Competitiveness Report (GCR), which is another set of indicators that ranks countries in order of their ‘business friendliness’. Unlike the EFWR, the GCR contains some original data which is based on what the WEF calls its ‘Executive Opinion Survey’ (EOS).

The EOS is a very serious data-gathering exercise that in its latest iteration collected the views of over 15,000 managers in 142 economies. The number of

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respondents in each country obviously varies, ranging from 30 in Belize to 422 in the USA. The average number of respondents in each country was 98.

One of the questions asked in the EOS is the following:

- How would you characterize the hiring and firing of workers in your country? [1 = impeded by regulations; 7 = flexibly determined by employers]

The average response of the executives surveyed in each country is used by the IMF authors as the sole indicator of the difficulty of hiring and firing in each national regulatory system.

There are a number of aspects of the EOS with which one could easily take issue on both technical and political grounds, not least the use of the highly loaded terms ‘impeded’ and ‘flexibly’ in the question above, and, more importantly, the fact that there may be unobserved factors that vary with the national context and that influence managers’ perceptions. Expectations about what it is reasonable to expect in terms of regulation or of how much discretion employers should have in firing decisions will obviously have an effect on the perception of how burdensome regulation actually is.

This having been said, the EOS undoubtedly provides some valuable information about the views of corporate managers around the world on a number of economic and regulatory issues. What it does not provide, however, is anything close to an objective assessment of the weight of regulatory burdens on business, still less of the value that compliance with regulation, no matter how burdensome, might have on the wider social and economic stage.

It defies methodological credibility that the authors of these reports should take an average of 98 uncorroborated responses per country to an arguably loaded question about regulation as a proxy for the actual regulatory situation, especially as the respondents are all corporate managers.

The other factor to which the authors draw particular attention is hiring costs. They find that “Indicators [of labour market flexibility] are in most of the cases negative and statistically significant, with hiring costs and youth unemployment having the strongest negative correlation.” (WP 65 p.5)

The hiring costs indicator refers to a figure in the EFWR called “mandated cost of hiring”, which, it is claimed, is based on World Bank data. It appears to be a combination of a discontinued Doing Business indicator called 'Nonwage Labor Costs', last used in 2008, and a figure representing the cost of paid vacations. It is not clear on what basis the overall calculation is made as the DB indicators do not in fact include a figure for the cost of paid vacations.

The nonwage labor costs indicator was a composite measure based on the cost of social security (pensions, sickness, health care, maternity leave, workplace injury, family allowance) and any other payroll taxes or obligatory employer contributions. Two points are worth making about this indicator.

First of all, even before the whole Employing Workers Indicator of the Doing Business Report was dropped, the Non-Wage Labor Costs indicator was abandoned by the World Bank in response to pressure from the international trade union movement and the International Labour Organization. The argument made against it was that it provided governments with a direct incentive to cut worker benefits as development assistance was

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in many cases conditional on a government taking measures to improve its place in the Doing Business rankings.

The second point is that, as used by the Bank, the indicator was at least honestly named. The costs involved are the costs of employing a worker, not the costs of hiring a worker. Referring to this indicator as 'hiring costs' gives the clear impression that the costs involved are somehow bound up with getting an employee onto the payroll and do not continue after that. It is at best a serious mistake.

Conclusions

The IMF paper reads as though the inference they intend policy makers to draw from their work is that the important goal of reducing youth unemployment requires more flexibility for employers to hire and fire at will and pay their workers what they like.

Of course, there is a careful nod in the direction of labour standards and job quality. The paper says that labour market ‘reforms’ "have to be properly designed to also improve the quality of employment and to minimize possible negative short-term effects.” (WP 64, p.4).

Yet it is immensely difficult to see how the quality of jobs can be improved on the basis of a definition of labour market 'reform' borrowed from a right-wing think tank that includes increasing the use of fixed term contracts, lowering minimum wages, removing restrictions on hiring and firing, reducing paid holidays, sick leave and maternity leave, and individualizing wage-setting.

One of the many problems with these papers is that the ridiculousness of this proposition is obscured by the fact that exactly what 'reform' involves is never spelled out. The authors seem to be too interested in their mathematical models to pay much attention to the logic of what they are actually arguing.

Rather than exercises in mathematics, what we need from institutions like the IMF is a serious approach to reconciling job creation and job quality. This will require the development of methods of data collection and analysis that more reliably indicate the full range of synergies and trade-offs between different labour market policies and employment outcomes. Then policy can be made more transparently and democratically with the aim of reducing unemployment without thereby encouraging employment practices that are incompatible with decent work.

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