

The Global Economy

Labor Markets



Regulation

- “Vital part of thriving markets?”
- “Flawed and crude?”
- Which one? Both? Neither?
- Examples?

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Idea for the day

- Regulation can be good or bad
 - Can facilitate productive activity
 - Can also be an obstacle to it
 - Needed: balance
- Today’s examples
 - Labor markets (first half)
 - Financial markets (second half)
 - Both essential to economic performance

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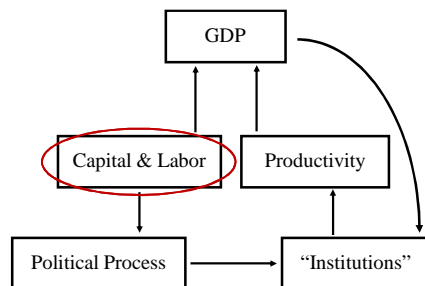
Where we’ve been

- Essential tool: production function

$$Y/L = A (K/L)^\alpha$$
- Sources of country performance
 - Capital per worker K/L
 - Productivity A
- Institutions: sources of productivity
 - Governance
 - Rule of law
 - Property rights
 - Competitive markets

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Where we’re going



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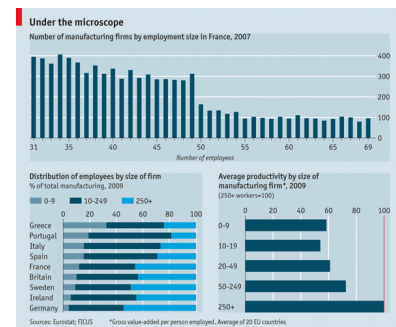
Roadmap

- Regulation ✓
- What’s going on in France?
- Labor market indicators
- Labor market analysis
- Labor market “protection” and “flexibility”
- Examples (skim at break, discussion by request only)

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What's going on in France?

What's going on in France?



Source: The Economist, March 3, 2012.

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What's going on in France?

- *Bloomberg Business Week*, May 3, 2012
 - Once a company has at least 50 employees, management must create three worker councils, introduce profit sharing, and submit restructuring plans to the councils if the company decides to fire workers for economic reasons.
- What's going on here? Who wins? Who loses?

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What's going on in France?

- Christopher Caldwell, *Financial Times*, Feb 05:
 - In early 2000, when the French unemployment rate was 9.6%, Martine Aubry, the Socialist labour minister, shepherded into law a bill that capped the work-week of most employees at 35 hours. She called it "a necessity for job creation." Today French labour participation is rock-bottom among developed countries.
- What's going on here? Who wins? Who loses?

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What's going on in France?

- Liz Alderman, *NYT*, February 20, 2013
 - "How stupid do you think we are?" wrote Titan CEO Maurice Taylor, an American. "The French work force gets paid high wages but works only three hours. They have one hour for their breaks and lunch, talk for three and work for three." He was roundly condemned in France for his "predatory" American corporate culture.
- What's going on here? Who wins? Who loses?

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What's going on in France?

- Jacqui Cheng, "Sacre bleu!" *Ars Technica*, March 13, 2013
 - It's a rule of retail life that you often have to work long past closing time while you clean up or do inventory for the following day. But Apple Store employees in France won't have to do this anymore. Apple has been ordered to stop asking its retail employees to work past 9pm and must now pay €10,000 in damages. French labor laws forbid requiring employees to work between 9pm and 6am (as well as Sundays, all day).
- What's going on here? Who wins? Who loses?

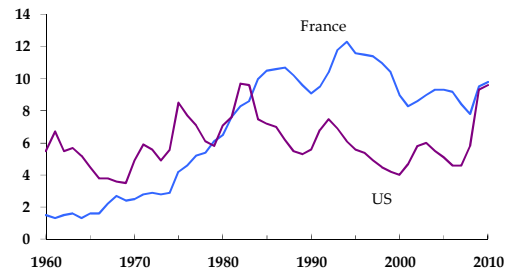
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What's going on in France?

- How do France and the US compare?
 - Unemployment?
 - Employment?
 - Hours worked?
 - GDP per capita?

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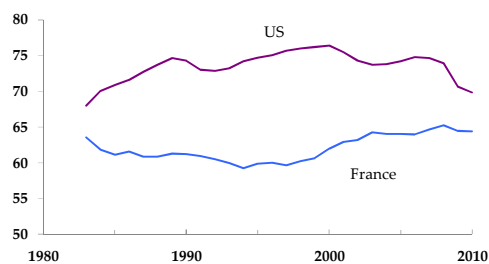
Unemployment rate



Source: OECD.

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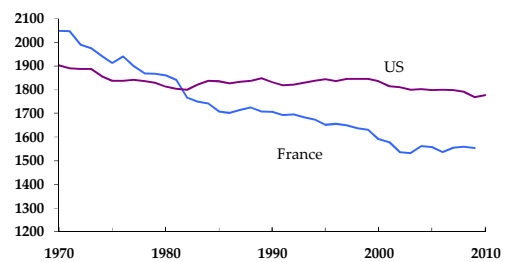
Employment rate



Source: OECD.

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Hours worked



Source: OECD.

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What's going on in France?

GDP per capita and GDP per hour worked

	Y/POP	Y/L	Y/hL
US	34,875	67,865	37.58
France	25,664	56,909	37.12
Ratio	1.36	1.19	1.012

Source: OECD and Penn World Tables.

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What's going on in France?

- How would you summarize the evidence?
- Explain it?

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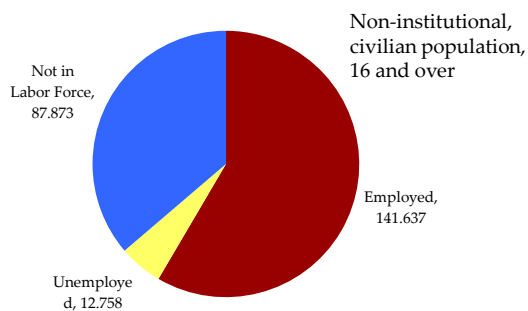
Labor Market Indicators

Labor market indicators

- What the numbers mean
- Why experts prefer employment to unemployment

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Employment "status" in the US



Source: BLS, Jan 2012.

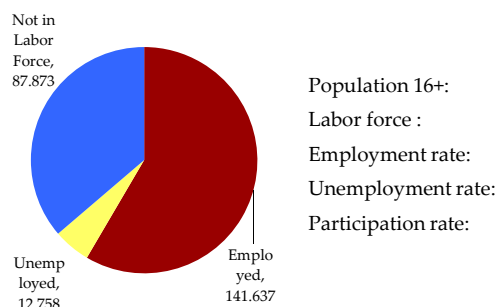
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Standard indicators

- **Employment rate** = employed/working-age population
- Labor force = employed + unemployed
- **Unemployment rate** = unemployed/labor force
- Participation rate = labor force/working-age population
- Inactivity rate = out of labor force/working-age population
- Hours worked = average hours worked of employed people

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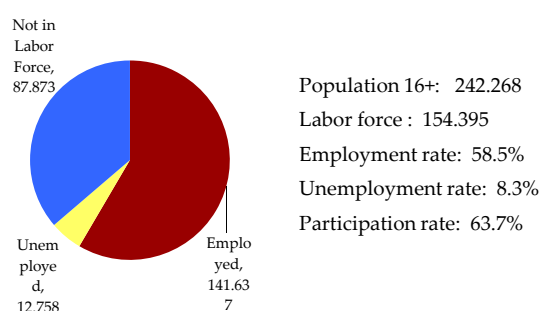
Employment status in the US



Source: BLS, Jan 2012.

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Employment status in the US



Source: BLS, Jan 2012.

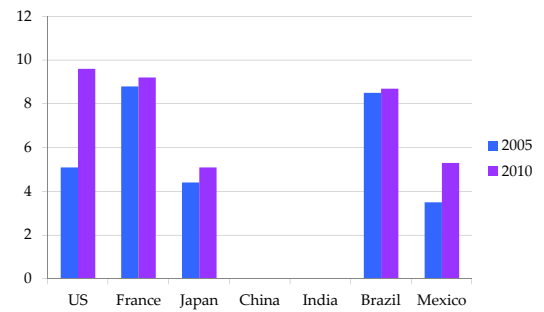
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Ways to reduce unemployment

- Unemployed get jobs
 - Raises employment rate
- Unemployed leave labor force
 - Employment rate doesn't change
 - Unemployment rate falls
- Which is more informative
 - Employment or unemployment?

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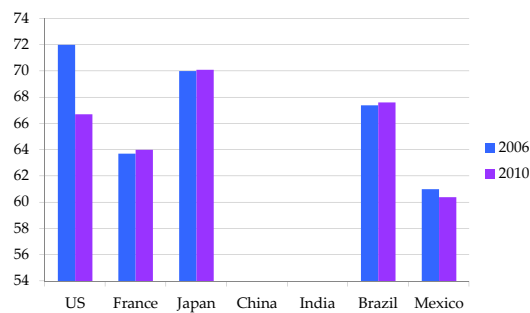
Unemployment rates



Source: OECD.

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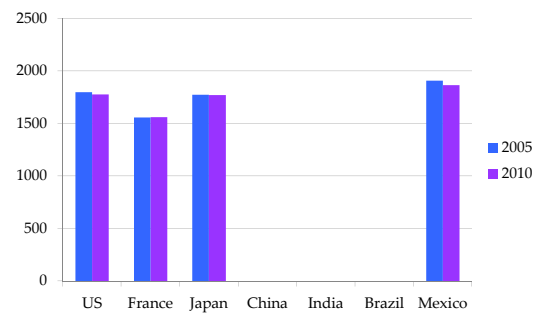
Employment rates



Source: OECD.

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Hours worked

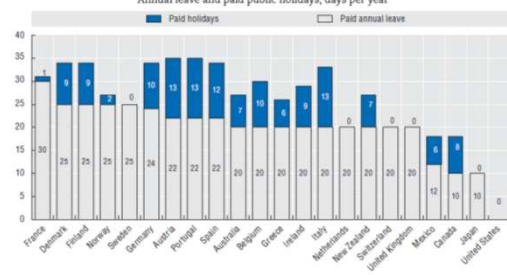


Source: OECD.

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Paid holidays and vacation

Figure 2.17. Paid annual leave and paid public holidays in the OECD
Annual leave and paid public holidays, days per year



Source: OECD.

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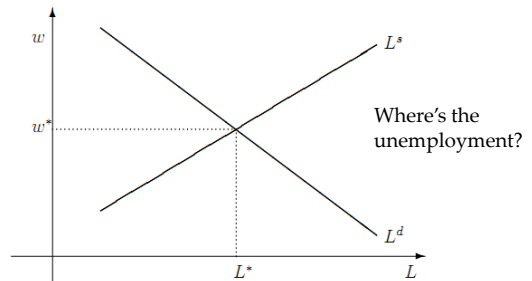
Labor Market Analysis

Why unemployment?

- Are jobs like donuts? hotel rooms? something else?
- Evidence is overwhelming that the number of jobs isn't fixed, it responds to circumstances

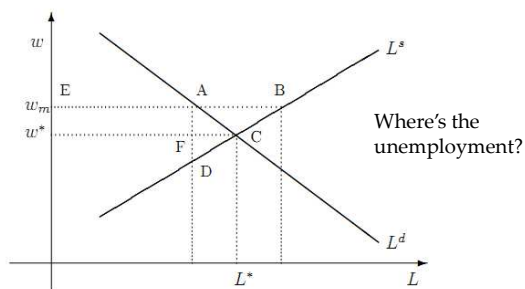
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Frictionless labor market model



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Institution: minimum wage



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Institution: minimum wage

- What happens to unemployment? Why?
- Is this a big effect or a small one?
- Who wins in the model? Who loses? Which is bigger?
- Who wins in the real world? Who loses? Which is bigger?

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Institution: minimum wage

- If we doubled pay at McDonald's, what would happen?

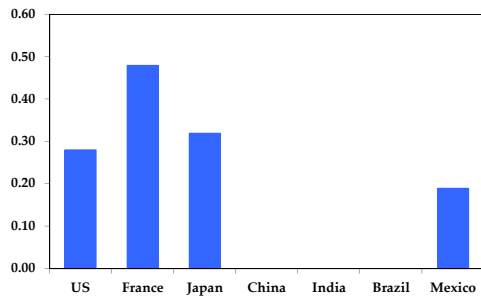
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Institution: minimum wage

- Who gets the minimum wage in the US?
 - 2.5% of US workers (3.3m)
 - Young: half are 16-24
 - White: 77%
 - Part-time: 64%
- What will happen if minimum wage goes up?
 - Best guess, hotly debated: increase of 1% in min wage reduces employment by 0.1 to 0.2% for adults, 0.3% for teens
 - If so, increase from 7.25 to 10.10 would reduce employment by ~0.3m [CBO estimates higher]

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Minimum wage (fraction of median)



Source: OECD.

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Institution: minimum wage

- Milton Friedman
 - The minimum wage is discrimination against people with low skills, because it forces firms to pay a wage greater than their skill supports. As a result, many of them are unemployed, rather than working and developing skills that would improve their prospects.
- Do you agree or disagree? Why?

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Institution: minimum wage

- Gary Becker, Becker-Posner blog:
 - Generous minimum wages and other rigidities of the French labor market caused unemployment rates that have remained stubbornly high. Immigrants, youths, and other new entrants into the labor market have been hurt the most.
- Do you agree or disagree? Why?

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Labor Market Institutions

“Protection” v “flexibility”

- What you’ll be dealing with in other countries
- Doing Business
 - Least flexible labor market = Portugal
 - Most flexible labor market = New Zealand
 - Examples of “euro” and “anglo” models
- Employment protection law (EPL) governs
 - Fixed term contracts
 - Overtime compensation
 - Dismissal
 - Collective bargaining

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“Protection” v “flexibility”

Fixed-term contracts

PRT Fixed term contracts allowed only in special situations (such as seasonal activity)

NZL Fixed term contracts are unrestricted, with no maximum duration period

Source: Botero, Djankov, La Porta, Lopez-de-Silanes, Shleifer, Regulation of Labor.

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“Protection” v “flexibility”

Overtime

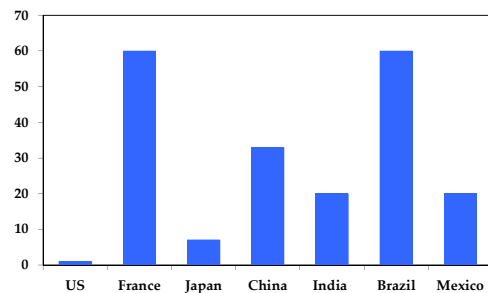
PRT Mandatory premium for overtime ranges from 50% to 75%, additional restrictions on night work, and there are 24 days of paid leave per year.

NZL No required premium for overtime, no restrictions on night work, and the minimum paid leave is 15 days per year.

Source: Botero, Djankov, La Porta, Lopez-de-Silanes, Shleifer, Regulation of Labor.

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Rigidity of hours (index)



Source: World Bank, Doing Business.

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“Protection” v “flexibility”

Dismissal

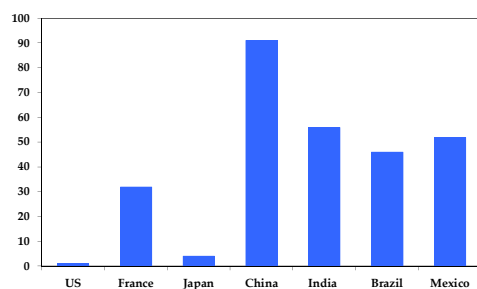
PRT List of fair grounds for terminations and stringent procedures for dismissals, such as mandatory notification of the government and priority rules for re-employment of redundant workers.

NZL Allows “contracts at will,” which can be terminated without notice without cause.

Source: Botero, Djankov, La Porta, Lopez-de-Silanes, Shleifer, Regulation of Labor.

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Firing costs (weeks of wages)



Source: World Bank, Doing Business.

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“Protection” v “flexibility”

Collective bargaining

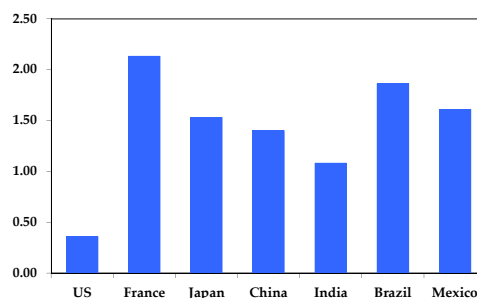
PRT Employers have a legal duty to bargain with unions, collective agreements are extended to third parties by law, workers councils are mandatory, and employer lockouts are prohibited.

NZL Employers have no legal obligation to bargain with unions, collective agreements are not extended, labor participation in management is not required, and employer lockouts are allowed.

Source: Botero, Djankov, La Porta, Lopez-de-Silanes, Shleifer, Regulation of Labor.

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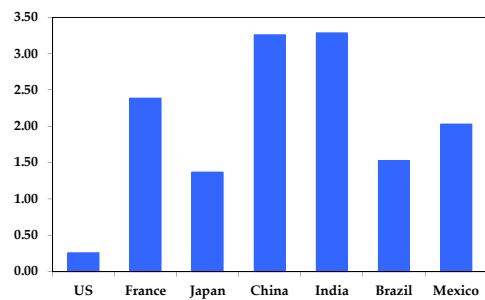
Union rights (index)



Source: Botero, Djankov, La Porta, Lopez-de-Silanes, Shleifer, Regulation of Labor.

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Overall employment protection (index)



Source: OECD.

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France revisited

- What happened?
- Would you build a plant there? Locate a bank?

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Time for a break

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Examples

Examples

- Countries where you've had experience?

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India

- Shankar Acharya, "Ten myths about India," FT Forum, Feb 1, 2010
 - Myth 4. Our labor laws protect labor. Quite the opposite. Present laws overprotect a tiny minority at the expense of the vast majority of workers. By making it extremely difficult to fire workers, our laws massively discourage the employment of new workers. They lead to huge under-utilization of our most abundant resource, low-skill labor.
- What's going on here? Who wins? Who loses?

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India

- Sean Dougherty, Veronica Frisanchio, and Kala Krishna, "Job protection in India," Vox EU:
 - We estimate the productivity effects of deregulation in state-level labor market policies. We find that even modest deregulation has improved total factor productivity substantially.
- What's going on here? Who wins? Who loses?

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Brazil

- EIU, *Country Commerce Report*
 - The 1988 federal constitution contains several important labour provisions: it legalises unions, collective bargaining negotiations, and the right to strike in both the public and private sectors. The constitution also sets overtime rates, provides a monthly minimum wage and regulates working hours. It lists a variety of labour entitlements, including the following: maternity leave, annual leave, workers' compensation, social services, medical assistance and unemployment benefits.
- What's going on here? Who wins? Who loses?

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Italy

- "Employment, Italian style," WSJ, June 25, 2012
 - Once you hire employee 11, you must submit an annual self-assessment to the national authorities outlining every possible health and safety hazard to which your employees might be subject.
 - Once you hire your 16th employee, national unions can set up shop.
 - Hire No. 16 also means that your next recruit must qualify as disabled. By the time your firm hires its 51st worker, 7% of the payroll must be handicapped in some way.
- What's going on here? Who wins? Who loses?

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Japan

- EIU, *Country Commerce Report*
 - Japan's labour system traditionally featured lifetime employment, elaborate fringe benefits, and wages based on length of service rather than performance. Most Japanese companies are finding this system increasingly difficult to sustain. But changing the social contract of lifetime employment has been difficult. The result is a massive number of unneeded workers in virtually every industry. The rigidity of the job market is partly offset by the growing presence of non-regular and part-time workers willing to work for less pay with no job security at all.
- What's going on here? Who wins? Who loses?

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Spain

- EIU, *Country Commerce Report*
 - High rates of unemployment have hindered Spain's economy for years, partly because of rigid labour laws that are among the strictest in the EU. Significant reforms that increase labour-market flexibility have been difficult to enact.
- What's going on here? Who wins? Who loses?

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Germany

- The Hartz reforms of 2002-05
 - Reduced benefits for long-term unemployment
 - Enhanced education and training
 - Facilitated private job sites
- Results
 - Employment and productivity up
 - Schroeder lost the next election
- What's going on here? Who wins? Who loses?

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US

- Econbrowser, November 2012
 - The recent health care legislation requires that that large companies either provide health insurance for full-time workers or pay a fee. But the Wall Street Journal reports that some are taking a third route-- shifting to more part-time workers.
- What's going on here? Who wins? Who loses?
- To be clear: this is speculative. We don't know yet what the effects of healthcare laws will be.

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US

- Caroline Baum, Bloomberg, September 4, 2013:
 - A higher wage is great for the workers who keep their jobs; it isn't so great for those who wouldn't get hired. With a higher minimum wage, the cost of automating certain tasks suddenly becomes more affordable.
- What's going on here? Who wins? Who loses?

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What have we learned?

- Wide variation in labor market institutions/regulations
 - Something to keep in mind when you're operating in another country
- Also variation in "outcomes"
 - Employment, unemployment, hours ...
- In flexible labor markets
 - Easier to lose a job
 - Easier to find one
 - Who wins? Who loses?

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Two weeks off in August

<http://youtu.be/qGISI48gkFc>

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Ghana mini-case

- What features do you need in this business?
- How does Ghana stack up?
- Good idea – or not?

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The Global Economy *Volatility & Financial Markets*

 NYU | STERN

Roadmap

- Two weeks off, Ghana mini-case ✓
- What's happening?
- Volatility
- Financial markets "game"
- Financial market institutions
- Crisis management

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What's happening?

- Mike Arroyo (Sat) asks:
 - Could weaker rule of law work to China's advantage? If it ignores hackers, could it benefit from theft of trade secrets?
- What do you think?

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What's happening?

- UK to issue RMB bonds
 - UK Treasury announced its intention to issue the first Western renminbi bonds.
- What's going on here?

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What's happening?

- AIG's lawsuit
 - In 2008, the Feds invested 184b in AIG in return for 80% of the equity.
 - USA Today: Former AIG CEO Maurice Greenberg is suing the federal government, arguing it illegally took a controlling interest in AIG without adequately compensating shareholders.
- Should the Feds have bailed out AIG? Were they too aggressive? Not aggressive enough?

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Volatility

Equilibrium

- Call me when we get there

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The idea

- Good economic performance requires effective labor and financial markets
- Especially in a volatile economic environment
 - Volatility calls for “reallocation:” moving labor and capital around to new products and industries
- Financial markets are hard to get right
 - They require lots of “infrastructure”
 - They sometimes freeze up

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Volatility

- Marx and Engels, *Communist Manifesto*, 1848
 - Everlasting uncertainty and agitation distinguish the bourgeois epoch from all earlier ones. All fixed, fast frozen relations ... are swept away, all new-formed ones become antiquated before they can ossify. All that is solid melts into air, all that is holy is profaned, and man is at last compelled to face with sober senses his real condition of life. ... **All old-established national industries have been destroyed or are daily being destroyed.** They are dislodged by new industries, whose introduction becomes a life and death question for all civilized nations.
- Does this sound right to you?

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Volatility

- Joseph Schumpeter, *Capitalism, Socialism & Democracy*
 - The process of **Creative Destruction** is the essential fact about capitalism. In capitalist reality, competition ... strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives.
- Does this sound right to you?

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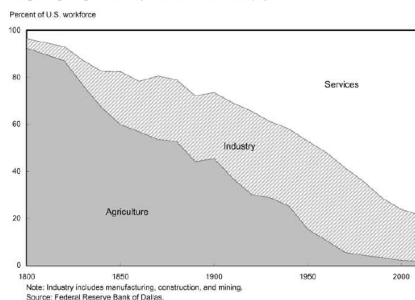
Volatility

- Adam Davidson, *Planet Money*, March 2013
 - In January, 4.2 million were hired. And 4.1 million quit or were fired. In other words, **every 1.6 seconds, someone got a job and someone else left a job.** Even in good economic times, new jobs are constantly being created and old jobs are constantly being destroyed.
 - There's a little-known jobs report that shows all this creation and destruction. It's called the Job Openings and Labor Turnover Survey, though it typically goes by the catchy acronym JOLTS.
- What's going on here?

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Volatility

Chart B-1 Percent of Private U.S. Workforce by Sector, 1890-2005
A large and growing share of the private U.S. workforce is employed in services.



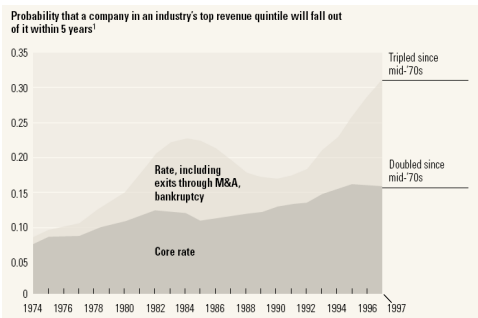
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Volatility

- Millions of farm jobs lost
- Millions of industrial jobs lost
- Where did they go?

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Volatility



Source: McKinsey Quarterly, "Extreme competition," 2005.

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Volatility

- Products come and go
- Firms come and go
- Industries come and go
- Good or bad?
- What does this mean for labor and capital markets?

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Volatility

- In a volatile world, do you want
 - "Fixed, fast relations"?
 - "Creative destruction"?
 - Why?

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France again

- Viscusi and Deen, "Why France...", *Bloomberg Business Week*, May 2012:
 - Pierrick Haan, CEO of a medical supply company, notes: "**The cost of labor isn't the main problem, it's the rigidities.** If you make a mistake in your hiring plans, you can't correct it." He plans to expand production in Tunisia, Bulgaria, or Romania.
 - Worker groups say the labor code itself isn't the issue. "If the code is complicated, it's because our society is complicated. Cars are much more complicated today than they were 40 years ago. Why shouldn't the labor code be?"
- What's going on here?

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Financial markets

Financial markets overview

- Obvious
 - Enforce property rights
- Less obvious: manage crises
 - Financial markets sometimes freeze up
 - Should we bail out banks? Why? Why not?

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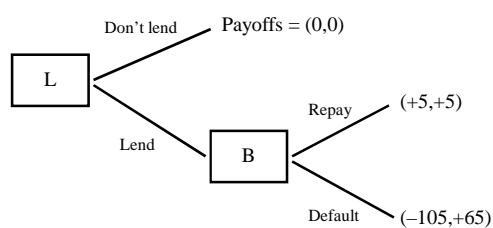
Lending game

Lending game

- A bit of game theory...
- Parameters:
 - Borrower has project that generates $100 + 15$
 - Lender offers 100 to borrower for one year
 - Lender's cost of funds is 5%, charges 10%
 - In default, borrower uses up 50, keeps the rest [Hmmm...]
- Where's the value in this game?
- Who gets it?

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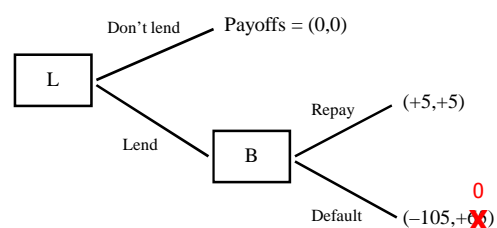
Lending game



What's the outcome? What can we do about it?

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Lending game



What's the outcome? What can we do about it?

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Lending game

- Note: **creditor rights are good for borrowers**
 - If default is attractive, lenders won't lend
 - Result: projects not funded, TFP lower than it could be
- Evidence
 - States/countries with stronger creditor rights have more lending, lower rates
 - Also higher GDP per capita

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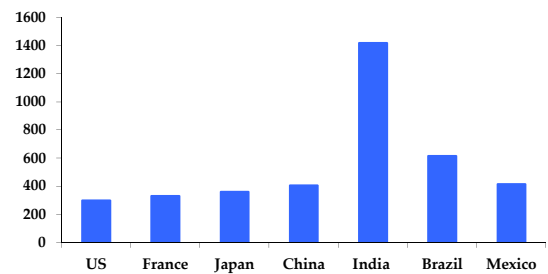
Financial market institutions

Financial market institutions

- Obvious: enforce property rights
 - Protect creditors
 - Governance of firms by owners
 - Disclosure of information to investors

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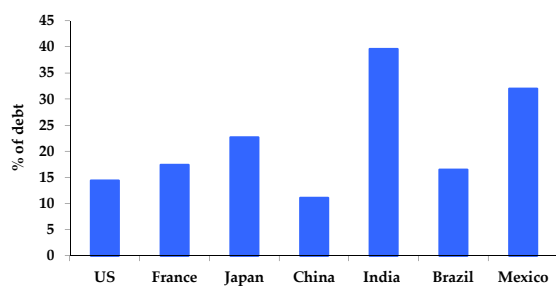
Days to enforce contracts



Source: World Bank, *Doing Business*.

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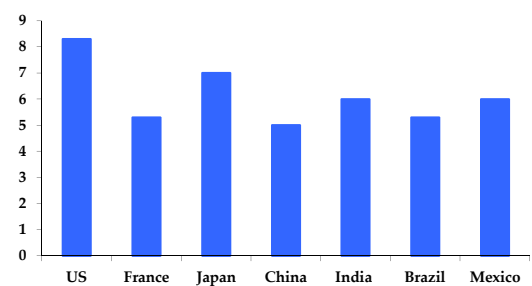
Cost of enforcing contracts



Source: World Bank, *Doing Business*.

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Investor protection (index)



Source: World Bank, *Doing Business*.

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Financial markets in action

Indicator	US	France	Ratio
GDP	6,297b	1,296b	5:1
Biomedical researchers	77,000	12,000	6:1
Public research funding	15.8b	1.8b	9:1
Industry research funding	18.6b	2.8b	7:1
Biotech patents	13,982	1051	13:1
Biotech startups	1,100	40	27:1
Publicly-traded biotechs	315	5	63:1
Recombinant proteins	97	0	∞:1

Source: Michelle Gittelman.

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Managing crises

Financial market institutions

- Less obvious: manage financial crises
 - Why not let failures happen?
 - Meltzer: “Capitalism without failure is like religion without sin”
 - But: they cause collateral damage
 - How do we balance these things?

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Financial crises happen

- Common in emerging markets
 - Mexico: 1982, 1994
 - Asian crisis: 1997
 - US: 1891, 1907, ...
- Developed countries too
 - Japan: 1990s
 - Scandinavia (Norway, Sweden, Finland): 1990s
 - All over: 2008-09

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Financial crises

- Matt Levine, *Bloomberg View*, Oct 10, 2014
 - Banks invest in risky assets and hand out risk-free claims to their savers. This bit of magic works most of the time, but sometimes people realize their risk-free claims are backed by risky assets, and they panic. The solution has been known for about 140 years. It's for the central bank to lend the banks money until the crisis passes.
 - Many people dislike this, and it is sort of unseemly, but it really is a well-known set of facts. You can reduce the risk of banking crises happening, but not to zero.
- What is he saying? Do you agree? Disagree?

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Managing financial crises

- Matt Levine, *Bloomberg View*, Oct 10, 2014
 - You want banks to
 - not do anything that could make them need a bailout
 - but take a bailout as soon as they need one.
 - Striking this balance is hard.
- What is he saying? Do you agree? Disagree?

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Managing financial crises

- Frozen financial system cause collateral damage
- So: protect banks through regulation
 - Deposit insurance
 - Limits on risk
 - Capital requirements to cover risks that go bad
 - Look closely at large banks (“systemic”)
 - Central bank lending when needed
 - Just banks or also money market funds, hedge funds?
 - [The details are mind-numbing]

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Managing financial crises: open issues

- Are governments capable of doing this well?
 - Complex rules invite influence, arbitrage
- Should failure be an option?
 - Let failures fail, deal with consequences
- Challenges
 - Just banks? Commercial paper? Money market funds? AIG?
 - Choluteca bridge problem
 - Dodd-Frank problem [aka Rube Goldberg]

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Choluteca Bridge



© Vincent J. Musi

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Dodd-Frank

After Congress passed the 848-page bill, government agencies began writing the rules to turn Congress' law into detailed implementing regulations.



1 word of Law



42 words of Rules



The over 15 million words of rules written to date represent 42 words published in the Federal Register for every 1 word of law.

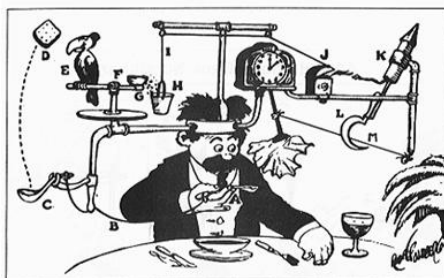
more than
15 million
words of rules

Source: Davis-Polk.

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Rube Goldberg

Self-Operating Napkin



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What have we learned?

- The world's a volatile place
 - Products, companies, and industries come and go
- Financial markets facilitate the reallocation of capital
 - With good institutions, they work better
- But they're prone to crises
 - A fact of life or something we can manage?

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For the ride home

- Are markets "moral"?
- Would you use them to
 - Set wages and salaries?
 - Buy and sell goods from other countries?
 - Solve gas shortages after natural disasters?
 - Allocate kidneys for transplants?
 - Why or why not?
- Read mini-case on course website
- Come to class prepared to discuss

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