
The Global Economy

Labor Markets



What's happening?

- Friday at 8:30am, the Bureau of Labor Statistics (BLS) released employment numbers for February:
 - The unemployment rate fell to 7.7%
 - Nonfarm employment ("jobs") rose 236k
- What does this mean? Which is more informative?

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Roadmap

- What's happening?
- Regulation good and bad
- What's going on in France?
- Labor market indicators
- Labor market analysis
- Labor market "protection" and "flexibility"
- What's going on in Denmark?

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Regulation good and bad

- James Surowiecki, *New Yorker*, June 10, 2010
 - Regulation isn't an obstacle to thriving markets, it's a vital part of them.
- Examples of good regulation? Bad?

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The 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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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 France
 - Here's a curious fact about the French economy: The country has 2.4 times as many companies with 49 employees as with 50. What difference does one employee make? Plenty, according to the French labor code. Once a company has at least 50 employees inside France, 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, the unemployment rate stands at 9.9% ... and 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?

- *Financial Times*, Feb 12 07:
 - Presidential candidate Segolene Royal laid out her economic vision: increase the minimum wage, scrap laws that make it easier for small companies to hire and fire employees.
- 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. Others said that France's 35-hour workweek, its rigid labor market and the influence that labor unions hold over the workplace have long been a source of aggravation for businesses.
- What's going on here? Who wins? Who loses?

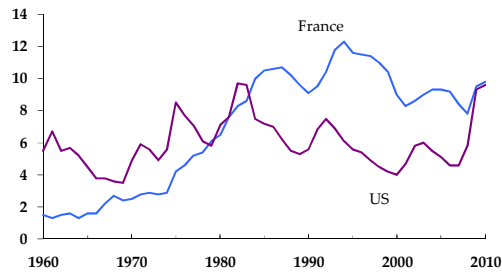
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What's going on in France?

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

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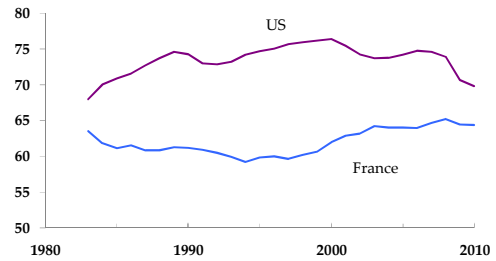
Unemployment rate



Source: OECD.

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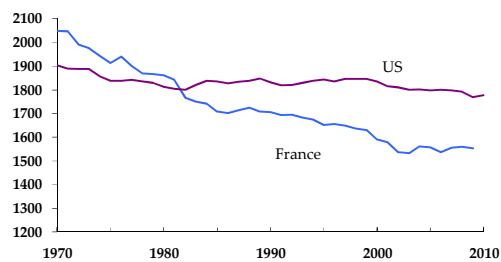
Employment rate



Source: OECD.

14

Hours worked



Source: OECD.

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What's going on in France?

Why is GDP per capita lower in France?

	Y/POP	L/POP	h
US	34,875	0.514	1806
France	25,664	0.451	1532
Ratio	1.36	1.14	1.18
Log of ratio (%)	30.7	13.1	16.5

Source: OECD and Penn World Tables, 2005.

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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
Log of ratio (%)	30.7	17.6	1.1

Source: OECD and Penn World Tables, 2005.

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What's going on in France?

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

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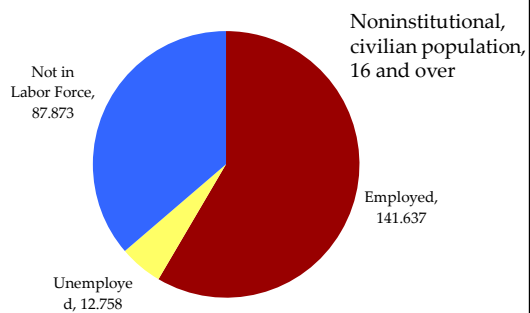
Labor Market Indicators

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.

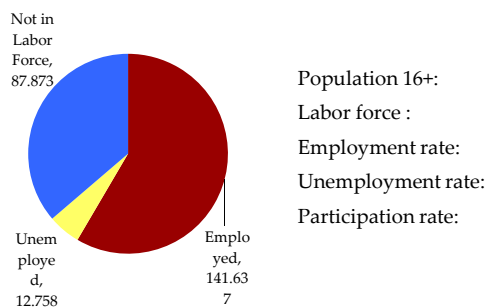
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Standard indicators

- **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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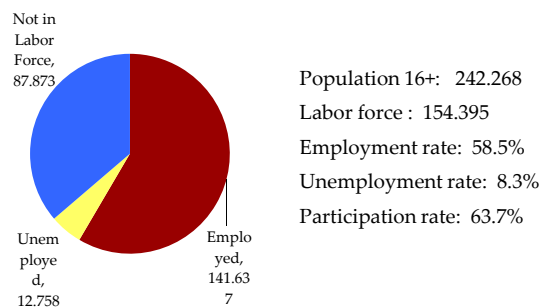
Employment status in the US



Source: BLS, Jan 2012.

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Employment status in the US



Source: BLS, Jan 2012.

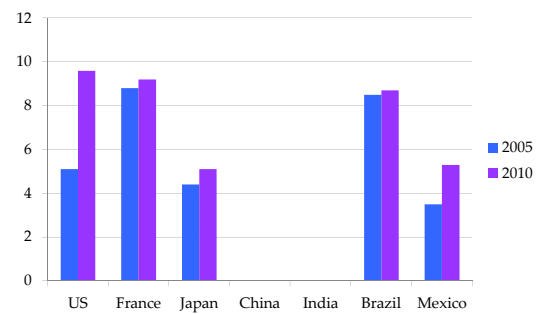
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Ways to reduce unemployment

- 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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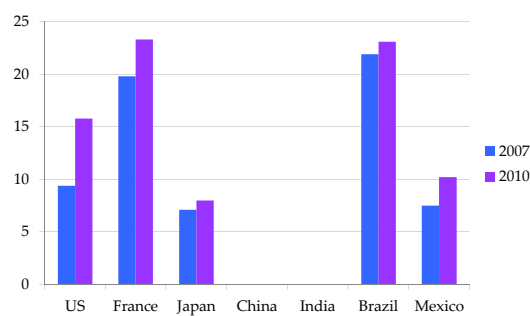
Unemployment rates



Source: OECD.

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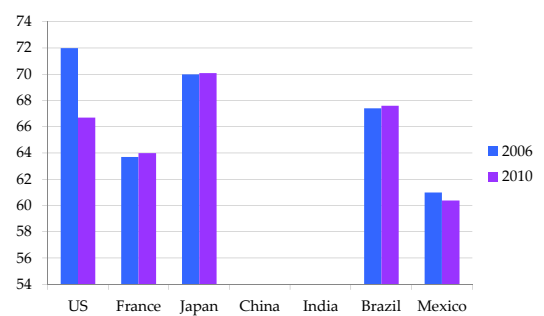
Unemployment rates, youths



Source: OECD.

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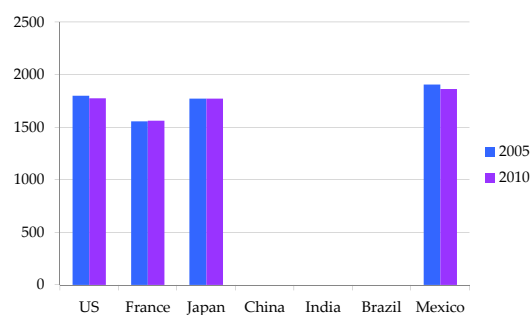
Employment rates



Source: OECD.

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Hours worked



Source: OECD.

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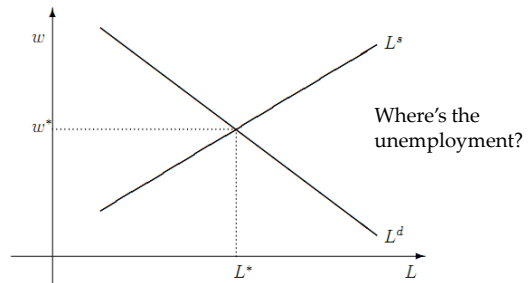
Labor Market Analysis

Why unemployment?

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

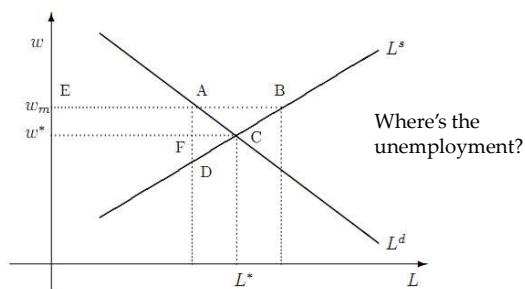
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Frictionless labor market model



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Institution: minimum wage



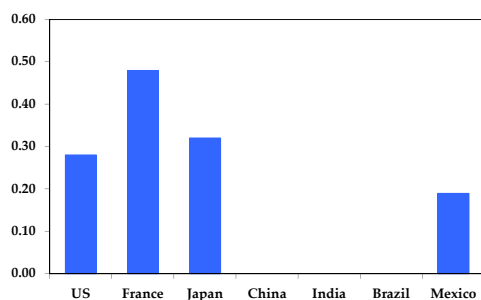
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Institution: minimum wage

- 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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Minimum wage (fraction of median)



Source: OECD.

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Institution: minimum wage

- Milton Friedman (paraphrase)
 - 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, 2006
 - Least flexible labor market = Portugal
 - Most flexible labor market = New Zealand
 - Use them as examples
- 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

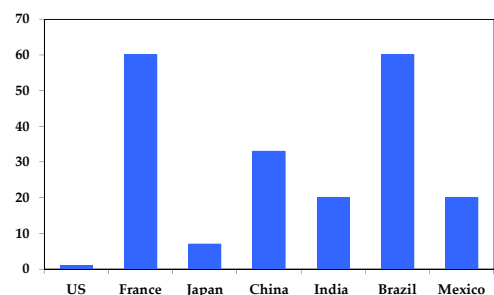
PRT Mandatory premium for overtime ranges from 50% to 75%, additional restrictions on night work, and there are 24 days of paid leave per year.

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

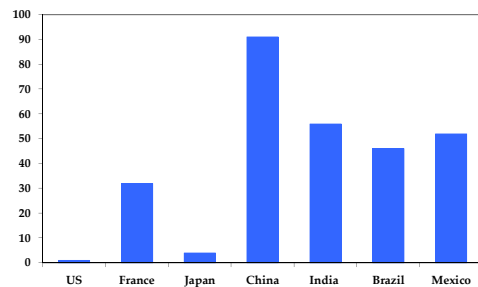
PRT List of fair grounds for terminations and stringent procedures for dismissals, such as mandatory notification of the government and priority rules for re-employment of redundant workers.

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

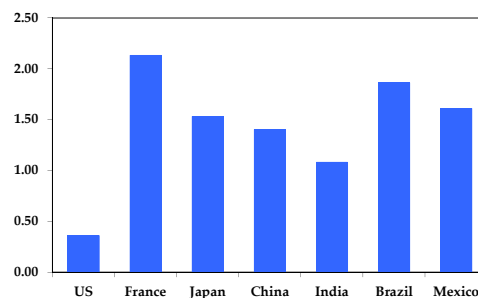
PRT Employers have a legal duty to bargain with unions, collective agreements are extended to third parties by law, workers councils are mandatory, and employer lockouts are prohibited.

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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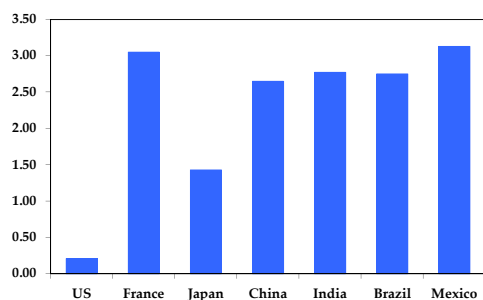
Union rights (index)



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

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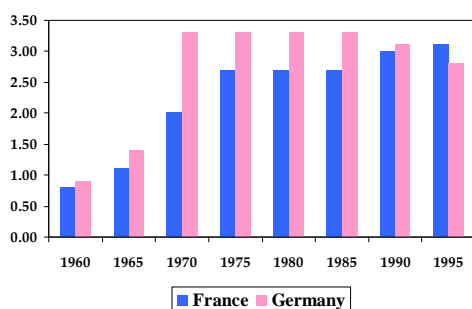
Employment protection overall (index)



Source: OECD.

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Employment protection over time



Source: Blanchard and Wolfers.

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France revisited

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

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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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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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Italy

- "Dangermen," The Economist, Feb 18, 2012:
 - A plaque marks the spot in Rome where Professor D'Antona was assassinated in 1999 by the Red Brigades. He was killed because he was working on plans for greater flexibility of Italy's labor market. Marco Biagi, who took up his standard, was murdered by the same group three years later. The two killings testify to the resistance to reform in a country where jobs-for-life is the culture and youth unemployment is over 30%.
- 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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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?

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What's going on in Denmark?

Denmark's "flexicurity" model

- Flexible labor markets
 - Flexible hours, easy to fire people
- Strong support for unemployed
 - Training programs
 - Subsidies to employers
- Results
 - Flexible labor market
 - Security for unemployed
 - Cost is 4-5% of GDP [OECD average 0.5%]

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Denmark's "flexicurity" model

- World Economic Forum
 - Denmark continues to distinguish itself as having one of the most efficient labor markets internationally, with more flexibility in setting wages, firing, and therefore hiring workers than in the other Nordics and in most countries more generally.
- 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 get one
 - Who wins? Who loses?

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After the break

- Be prepared to discuss Ghana

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The Global Economy

Volatility & Financial Markets

Roadmap

- Ghana mini-case
- What's happening?
- Volatility
- The capital markets "game"
- Financial market institutions
- Crisis management

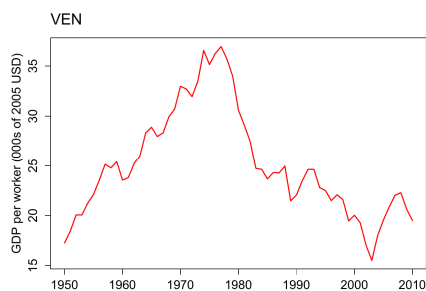
Ghana mini-case

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

What's happening?

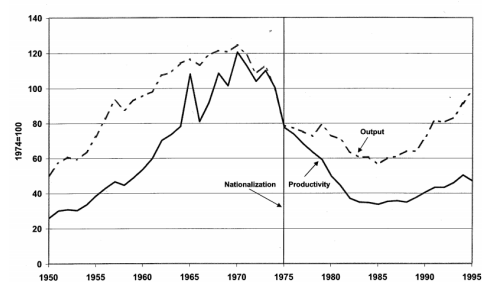
- Simon Romero, "A polarizing figure," NYT, March 5, 2013
 - Hugo Chávez, who died on Tuesday at 58, rose from poverty in a dirt-floor adobe house to unrivaled influence in Venezuela as its president, consolidating power and wielding the country's oil reserves as a tool for his Socialist-inspired change. ... He was a man of mixed ancestry — African, indigenous and Spanish — who despised a power structure dominated by Europeanized elites.
- Was he good or bad for Venezuela? Why?

What's happening?



What's happening?

Figure 11. Output and Labor Productivity of the Petroleum Industry in Venezuela (1950-1997)



Source: Cole, Ohanian, Rascos, and Schmitz, "Latin America in the rearview mirror."

The idea

- Good economic performance requires effective labor and financial markets
- Especially in a volatile economic environment
- Financial markets are hard to get right
 - They require lots of “infrastructure”
 - “That’s where the money is”
 - They sometimes blow up

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Volatility

Equilibrium

- Call me when we get there

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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 and his relations with his kind. 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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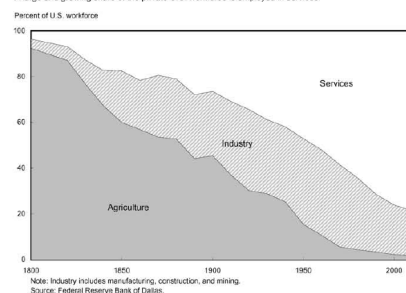
Volatility

- Joseph Schumpeter, *Capitalism, Socialism and 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

Chart 8-1 Percent of Private U.S. Workforce by Sector, 1800–2005
A large and growing share of the private U.S. workforce is employed in services.



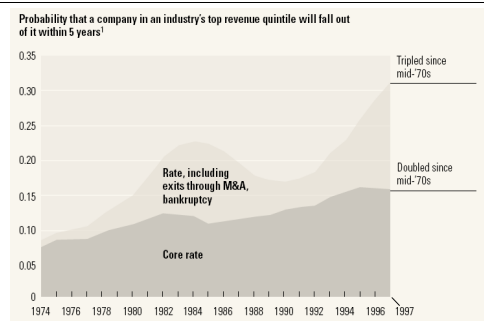
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Volatility

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

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Volatility



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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

- If the world is volatile, do you want
 - "Fixed, fast relations"?
 - "Creative destruction"?
 - Why?

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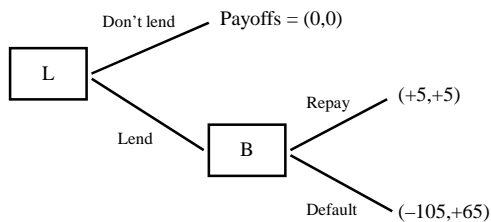
Capital markets game

Capital markets 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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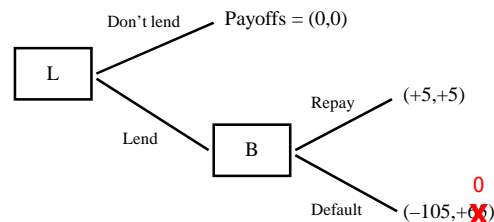
Capital markets game



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

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Capital markets game



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

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Capital markets game

- Note: creditor rights are good for borrowers
 - If default is attractive, lenders don'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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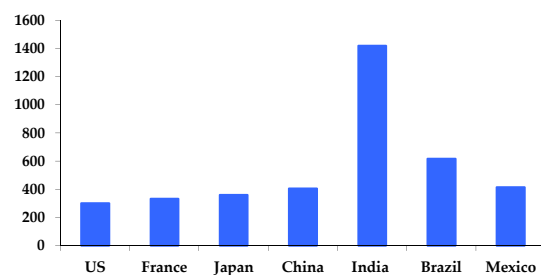
Financial market institutions

Financial market institutions

- Obvious: enforce property rights
 - Protect creditors
 - Governance of firms
 - Disclosure
- Less than 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 concerns?

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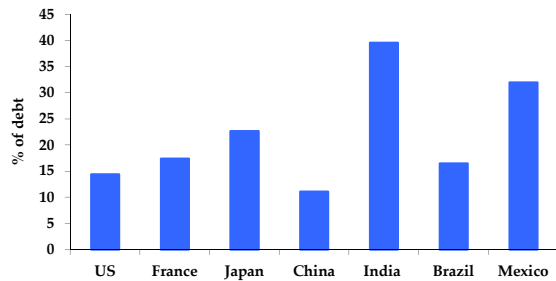
Days to enforce contracts



Source: World Bank, Doing Business.

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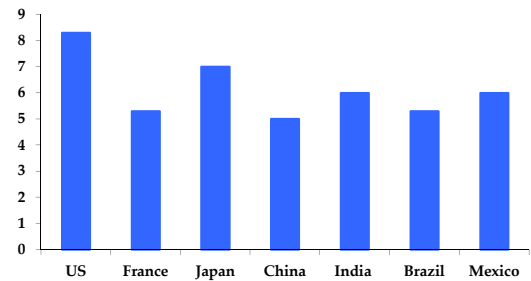
Cost of enforcing contracts



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 biotech	315	5	63:1
Recombinant proteins	97	0	∞:1

Source: Michelle Gittelman.

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Managing crises

Financial crises happen

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

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Financial crises as “runs”

- Friedman and Schwartz on the 1930s
 - The failure of one bank can produce “runs” on other banks that in turn might force even “sound” banks to close
 - Federal deposit insurance has succeeded in achieving a major objective of reform, namely, the prevention of runs
- What are they saying? Do you agree? Disagree?

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Financial crises: regulation basics

- Insolvent banking system bad for the economy
- Therefore: protect the banks through regulation
 - Deposit insurance
 - Limits on risk
 - Close or merge insolvent banks
 - Look closely at large banks (“systemic”)
 - Central bank lending when needed
 - Mind-numbing detail

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Financial crises: open issues

- Are governments capable of doing this well?
 - Complex rules invite arbitrage
- Should failure be an option?
 - Let failures fail, deal with consequences
- Just banks?
 - Commercial paper? Money market funds?

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What have we learned?

- Limerick version

The market's a clever creation
And a hallmark of civilization.
Though it's good to be free,
I-ron-i-cal-ly,
It isn't, without regulation.
- <http://www.limericksecon.com/2013/01/free-markets.html>

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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 subject to crises
 - A fact of life or something we can manage?

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Problem Set #2

- Due next class
- Post questions on Announcements & Discussion
- Or email me

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Something for the ride home

- Are markets “moral”?
- Would you use them to
 - Set wages and salaries?
 - Buy and sell goods from other countries?
 - Allocate kidneys for transplants?
- Where would you draw the line?

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