
The Global Economy

Labor Markets



The idea

- 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

2

Roadmap

- In the news
- Discussion: regulation good and bad
- What's going on in France?
- Labor market indicators
- Labor market analysis
- Labor market institutions: "protection" v "flexibility"
- What's going on in Denmark?

3

In the news

- "Protected and inefficient," *The Economist*, Feb 18, 2012
 - Regulation of professional services is stricter in Germany than in all but 5 of the 27 countries ranked by the OECD. Only qualified pharmacists can own a pharmacy. Mario Monti notes that there is "still lots of room to liberalize" law and medicine, too.
- What's going on here? Who wins? Who loses?

4

In the news

- ISDA, Mar 1, 2012 (rough paraphrase)
 - We were asked whether any agreements to date on restructuring Greek debt constitute Restructuring Credit Events. The Committee determined that it had not received any evidence of such an agreement and therefore unanimously determine that a Restructuring Credit Event has not occurred.
- What's going on here? Who wins? Who loses?

5

In the news

- "China's Billionaire Congress," Bloomberg, Feb 27 2012
 - The net worth of the 70 richest delegates in China's National People's Congress, which opens its annual session on March 5, rose to 565.8 billion yuan (\$89.8 billion) in 2011, a gain of \$11.5 billion from 2010, according to figures from the Hurun Report.
 - [The wealthiest member of the US Congress is Darrell Issa, who had a maximum wealth of \$700 million in 2010.]
- What's going on here? Who wins? Who loses?

6

In the news

- “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?

7

In the news

- Adam Davidson, “London and New York,” *NY Times*, Feb 29, 2012
 - Every month, some young bureaucrat in the Chinese State Administration of Foreign Exchange reaches out to a trader in London and buys or sells billions of dollars’ worth of U.S. Treasury bonds. You’ve heard the overblown fears that China owns too much U.S. debt, but you might not realize that it’s a British firm that regularly gets the commission. That’s because **London is the world’s largest market for dollars.**
- What’s going on here? Who wins? Who loses?

8

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?

9

What’s going on in France?

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?

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?

What's going on in France?

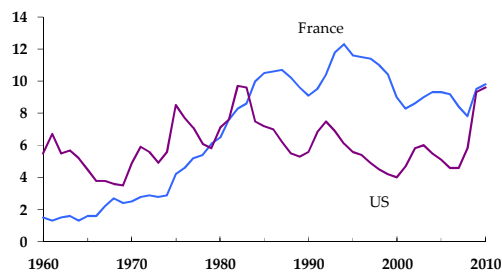
- *The Economist*, Feb 1 07:
 - France's Nicolas Sarkozy took his campaign to London, calling it "one of the biggest French cities." London is thought to have at least 300,000 French citizens – and voters. Journalists noted that France's unemployment rate is 8.6%, compared with 5.5% in Britain, and has not dipped below 8% for nearly 25 years.
- What's going on here? Who wins? Who loses?

What's going on in France?

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

14

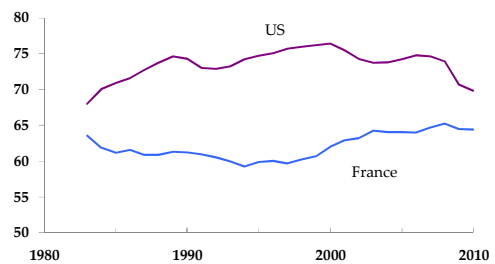
Unemployment rate



Source: OECD.

15

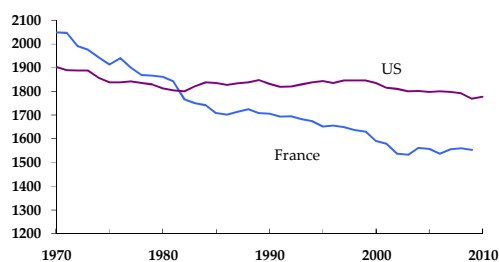
Employment rate



Source: OECD.

16

Hours worked



Source: OECD.

17

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.

18

What's going on in France?

Compare to GDP per hour worked:

$$Y/POP = (Y/hL) (L/POP) h$$

	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.

19

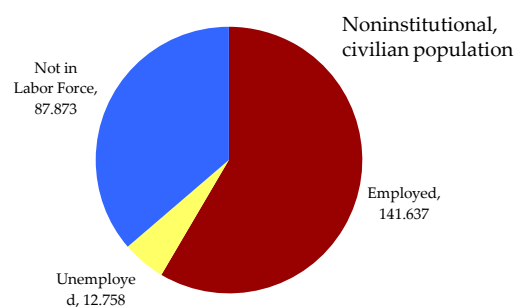
What's going on in France?

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

20

Labor Market Indicators

Employment "status" in the US



Source: BLS, Jan 2012.

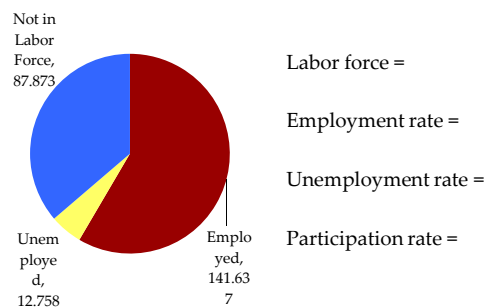
22

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

23

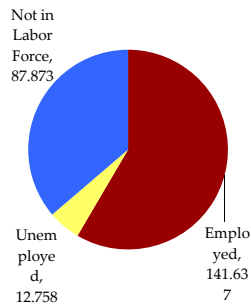
Employment status in the US



Source: BLS, Jan 2012.

24

Employment status in the US



Labor force = 154.395

Employment rate = 54.5% [??]

Unemployment rate = 8.3%

Participation rate = 63.7%

Source: BLS, Jan 2012.

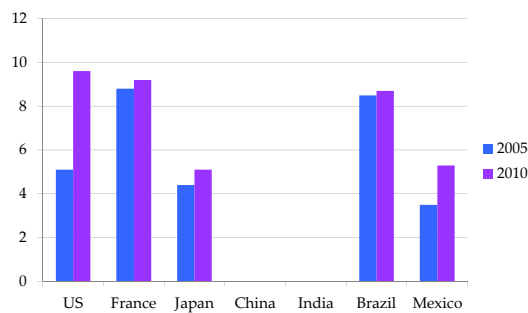
25

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?

26

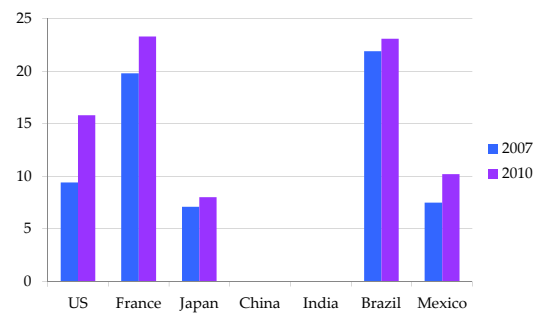
Unemployment rates



Source: OECD.

27

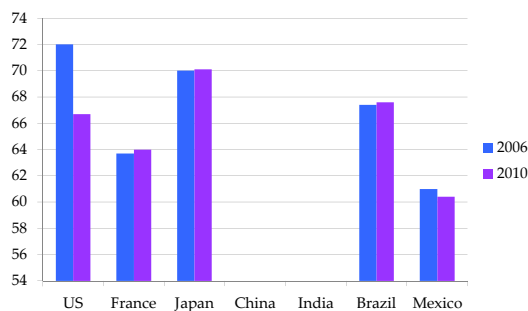
Unemployment rates, youths



Source: OECD.

28

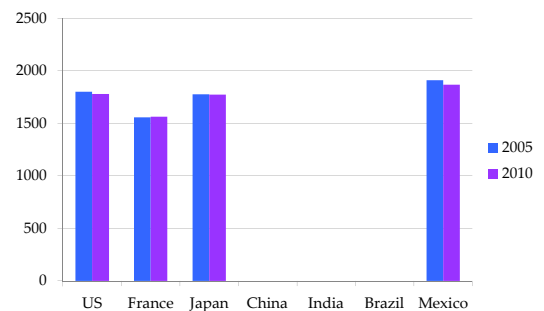
Employment rates



Source: OECD.

29

Hours worked



Source: OECD.

30

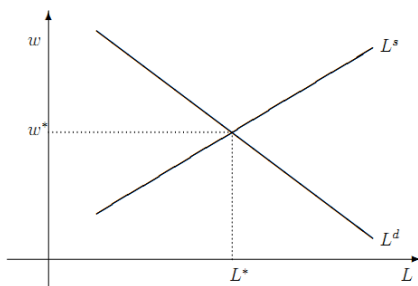
Labor Market Analysis

Why unemployment?

- What would you suggest?
- Are jobs like apples? hotel rooms? something else?

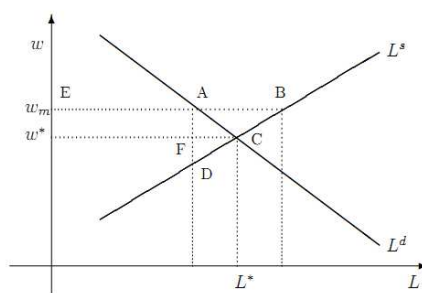
32

Frictionless labor market model



33

Institution: minimum wage



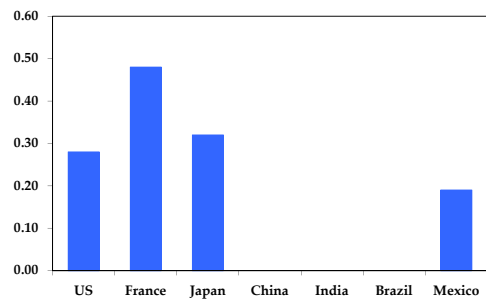
34

Institution: minimum wage

- What happens to unemployment? Why?
- Who wins in the model? Who loses?
- Who wins in the real world? Who loses?

35

Minimum wage (fraction of median)



Source: OECD.

36

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?

37

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?

38

Labor Market Institutions

“Protection” v “flexibility”

- 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

40

“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.

41

“Protection” v “flexibility”

Overtime

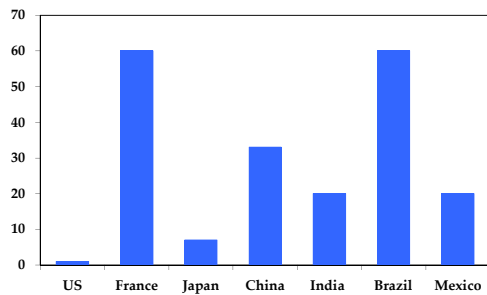
PRT Mandatory premium for overtime ranges from 50% to 75%, additional restrictions on night work, and there are 24 days of paid leave per year.

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.

42

Rigidity of hours (index)



Source: World Bank, Doing Business.

43

“Protection” v “flexibility”

Dismissal

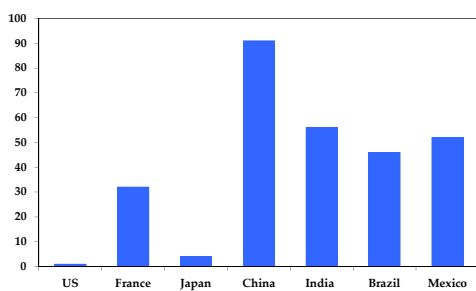
PRT List of fair grounds for terminations and stringent procedures for dismissals, such as mandatory notification of the government and priority rules for re-employment of redundant workers.

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.

44

Firing costs (weeks of wages)



Source: World Bank, Doing Business.

45

“Protection” v “flexibility”

Collective bargaining

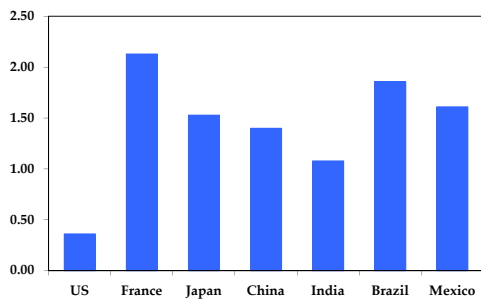
PRT Employers have a legal duty to bargain with unions, collective agreements are extended to third parties by law, workers councils are mandatory, and employer lockouts are prohibited.

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.

46

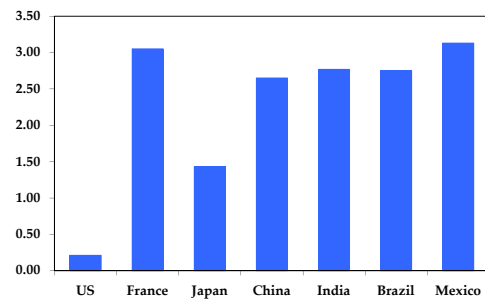
Union rights (index)



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

47

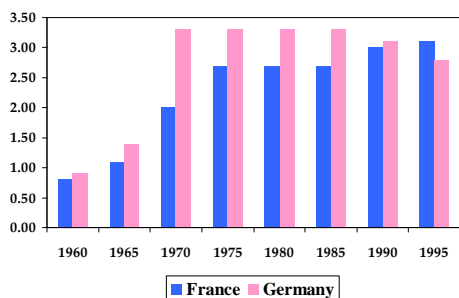
Employment protection overall (index)



Source: OECD.

48

Employment protection over time



Source: Blanchard and Wollers.

49

France revisited

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

50

France

- New York Times, Oct 9, 2005
 - The French government is trying to make it easier for small companies to lay off workers. ... Some European experts say that French and German leaders are at least looking at the heart of the unemployment problem: that companies are not likely to hire more freely unless they can fire more freely. As economist Katinka Barysch put it, “the best place to lose your job is in a country where it’s easiest to find a new job.”
- What’s going on here? Who wins? Who loses?

51

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?

52

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?

53

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?

54

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%]

56

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?

57

What have we learned?

- Wide variation in labor market institutions
 - 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?

58

After the break

- Be prepared to discuss Ghana

59

The Global Economy

Volatility & Financial Markets

NYU  STERN

Roadmap

- Ghana mini-case
- Volatility
- The capital markets “game”
- Financial market institutions
- Crisis management

61

Ghana mini-case

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

62

The idea

- Good economic performance requires effective labor and financial markets
- Especially in a volatile economic environment
- Financial markets are harder to get right
 - They require lots of “infrastructure”
 - “That where the money is”
 - Periodic financial crises

63

Volatility

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?

65

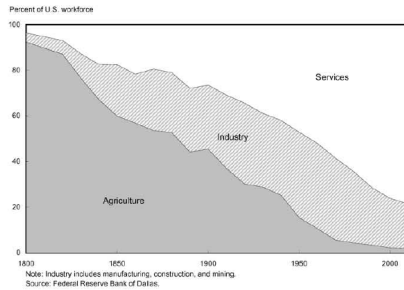
Volatility

- Joseph Schumpeter, *Capitalism, Socialism and Democracy*
 - The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers, goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates. **This 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?

66

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.



67

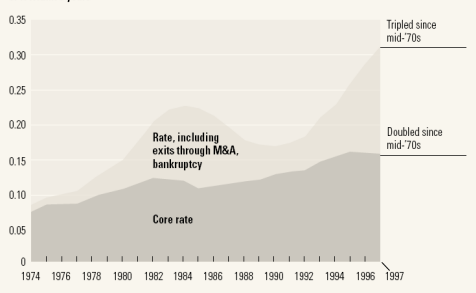
Volatility

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

68

Volatility

Probability that a company in an industry's top revenue quintile will fall out of it within 5 years¹



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

69

Volatility

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

70

Volatility

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

71

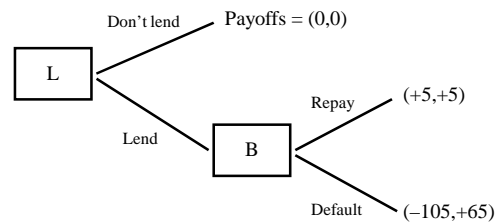
Capital markets game

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%, the competitive risk-adjusted rate
 - In default, borrower uses up 50, keeps the rest
- Where's the value in this game?
- Who gets it?

73

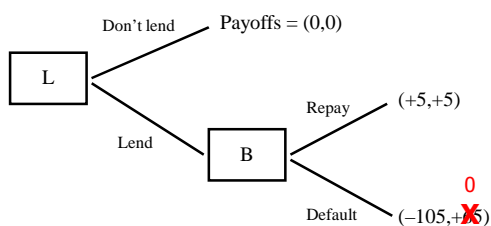
Capital markets game



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

74

Capital markets game



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

75

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

76

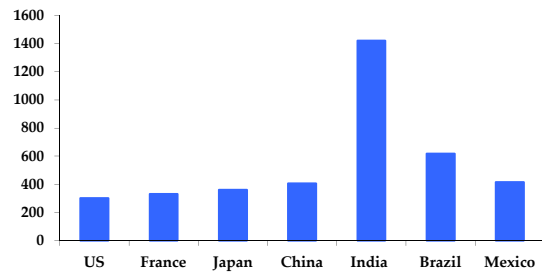
Financial market institutions

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
 - More shortly

78

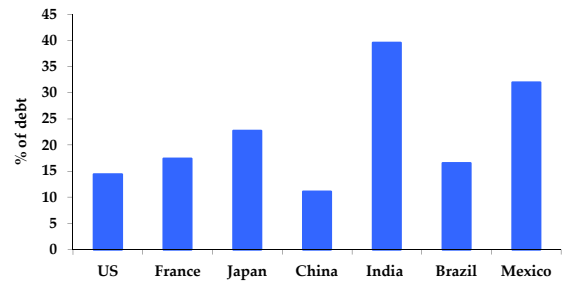
Days to enforce contracts



Source: World Bank, *Doing Business*.

79

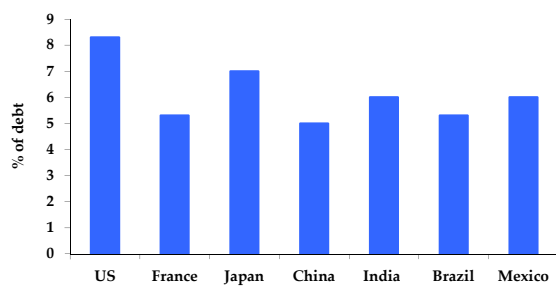
Cost of enforcing contracts



Source: World Bank Group, *Doing Business*

80

Investor protection (index)



Source: World Bank Group, *Doing Business*

81

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

82

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

84

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?

85

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

86

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?

87

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, this works better
- But they’re subject to crises
 - A fact of life or something we can manage?

88

Something for the ride home

- Tyler Cowen, New York Times, Feb 11, 2012
 - Bailing out financial institutions deemed “too big to fail” has become wildly unpopular, but breaking them up is probably not the best way forward, because it penalizes size instead of failure.
 - But **why not make shareholders liable for the first \$1.50 — or more — of losses** as insolvency approaches? We would be making the shareholders liable for the costs that bank failures impose on society, and making the banks sort out the right mixes of activities and risks.
- Good idea or bad? Explain.

89