

Comments on Heckman-Pagés

This stimulating paper surveys existing sources of information and provides new evidence on the costs of a specific set of labor policies. In particular, it tries to determine the effect of job security provisions in labor legislation on employment. The paper finds that, contrary to what has been argued recently in the literature, labor market regulation designed to improve job security brings about significant costs in terms of employment. However, the effect of such provisions on the rate of unemployment is found to be rather weak.

To put the purpose of this paper into perspective it is useful to review briefly the main challenges that are recognized in the current debate on labor markets in the major Latin American economies. I will focus especially on the experience of Argentina, at present the Latin American economy with the highest unemployment rate in the region, and an exchange rate regime (Convertibility) that requires labor market flexibility to improve the economy's ability to respond to real external shocks.

If we look at the debate on labor markets during the 1990's, the discussion has taken place on four main areas. The first area relates to the role of unions in the process of negotiation of labor contracts. The central question here is how efficiency and labor flexibility in the economy is related to the prevailing type of collective bargaining process, in particular whether it is centralized at a sectoral or economy-wide level or whether it is decentralized at the firm level.

Although it is generally agreed that decentralization favors efficiency, in practice there are cases of sectors in which centralized collective bargaining agreements have introduced significant flexibility in their labor contracts. In the Argentine context, this

has lead employers representatives to hold a rather eclectic view on the issue. Judging on the basis of the wide spectrum of opinions that exists among employers' representatives on the convenience of decentralized negotiations, it appears that an essential element that affects employers' views on this issue is relative attitude that central unions and individual firms' union representative adopt during negotiations.¹

The second area refers to the role of unions in terms of their political power and, hence, their ability to impose through legislation mandatory contributions (taxes) on firms to finance the unions' bureaucracy or the monopolistic provision of health services (obras sociales). Very linked to this part of the debate, the third area refers to tax policy and, more specifically, to the level of social security contributions levied on firms.

Finally, the forth area refers specifically to labor legislation. In particular, it focuses on the provisions included in labor contracts that affect the ability or the cost of hiring and dismissing workers. Severance payments, advance notification, seniority provisions are central elements in this part of the debate. The discussion around the effects and costs of labor provisions is not independent from the consideration of legal risks involved for firms in countries where courts have produced significant jurisprudence favoring workers in the litigation process.

Within this debate, the bulk of the paper focuses essentially the last set of issues and produces the main contributions. Although the first section of the paper are devoted in part to the issues of collective bargaining and labor taxes, I find the analysis of these

¹ To provide a specific example from the Argentine experience, the Government observed that during discussions on proposed modifications to existing legislation, employers' representatives from the financial and construction sectors favored centralized over decentralized negotiations while the opposite was true in the case of representatives from industry. Also, employers' representatives from large firms were rather indifferent to this issue, while representatives from small firms expressed a strong preference for decentralized labor negotiations.

two topics too brief to obtain significant insights into the debate. Also, I have doubts whether it makes sense for the analysis to put together payroll contributions to finance a pay-as-you-go system (which are equivalent to taxes), with personal contributions to private pension funds (which are more associable to the concept of savings).

Turning to the main part of the paper, the authors' first contribution is to provide a comprehensive survey of job security provisions in Latin American and Caribbean countries focusing on their general legal framework. In particular, the paper provides valuable information on whether labor contracts are regulated by specific labor codes or whether they are subject to common law, and examines the major job security provisions such as advance notification, dismissal compensation (whether under just or unjust cause), and the existence of a seniority premium.

Then, a Job Security Index is constructed using these elements. The Index maps regulatory provisions into a cost measure as percent of wages. In this way, the authors claim, one can move from a qualitative to a quantitative analysis of the impact of these labor regulations on employment.

I find this section of the paper and the Job Security Index useful. However, inspection of Table 1 leaves me with some doubts about the implied ordering of different countries in their sample. In particular, it is somewhat surprising to find most European countries (famous for their inflexible labor legislation) ranked as having less labor market regulations than Latin American and Caribbean countries. Also, within Latin America it is quite surprising to find Chile with one of the highest values of the Job Security Index. Given the importance of the rankings presented in Table 1 for the empirical analysis, it

would be useful for the reader to have a better sense of the sensitivity of the Index to various assumptions.

In particular, given that the Index is constructed using exclusively provisions existing in labor codes, it generates a bias in favor of common law countries where effective job security provisions emanate directly from private contracts and the legal jurisprudence applied by courts. In addition, in some countries with fairly rigid labor legislation, de-facto labor flexibility has been brought about through collective agreements. Thus, an excessively “legalistic” approach may miss some of the actual characteristic of labor markets in the region.

A second element affecting the construction of the index is the discount rate. The authors choose to use a single discount rate for all countries in the sample. However, it may be argued that the relevant discount rate for calculating the expected discounted cost of dismissing a worker is significantly higher in developing than in industrial countries. A possible notion of the relevant discount rate in developing countries could be obtained using existing measures of country-risk. Again, it would be useful for the reader to have a sense of how the values in Table 1 are sensitive to changes in the discount rate.

The main objective of the paper is to estimate the impact of labor regulations on employment. Section 3 of the paper addresses this in two ways. First, it relies on existing estimates of labor demand elasticities obtained from a sample of studies to simply infer the effect of labor regulations on employment. The authors find that static labor demand elasticities estimated in the literature range between zero and minus one with most of the cases clustered within -0.2 and -0.6 . Even assuming that workers may bear part of the cost of labor regulations in the form of lower equilibrium wages, these

estimates of labor demand suggest prima-facie a potentially significant effect of job security provisions on employment. Of course, the size of the effect is measured directly by the labor demand elasticity. However, the values of the elasticities may be directly influenced by how efficiently the labor market functions. For instance, in countries with relatively rigid labor markets, we may find that price-elasticities of labor demand may tend to be large relative to the output elasticities of labor demand. As an example of this phenomenon, we may compare the relative size of price and output elasticities of labor demand in Argentina and Chile. Thus, the measure of the effect of job security provisions on employment may be influenced by other elements affecting the functioning of labor markets.

The authors also survey a number of studies that attempt to measure more directly the impact of job security provisions on employment. They report that a number of studies find that such labor market regulations have a significant effect on turnover rates. The impact on average employment, however, appears to be somewhat weaker.

In view of these results, the authors construct a data set spanning industrial and Latin American countries to estimate the effect of job security provisions, as measured by the Job Security Index, on employment, its composition, and on the rate of unemployment. I find their results convincing in showing a significant effect of labor market regulation on employment rates. Also the results show a strong impact of regulations on youth employment. Somewhat surprisingly, the effect on unemployment in Latin American countries appears to be much weaker. The authors suggest that this finding may reflect the fact that, in the absence of unemployment insurance or equivalent support programs, workers tend to either find jobs quickly or tend to drop out of the labor

force. This explanation, however, does not appear to be consistent with the fact that some Latin American countries currently report unemployment rates comparable to those of some European economies.

In sum, I find this paper valuable in two ways. First, it provides an important survey of current labor legislation in Latin America and the Caribbean. Second, the results are relevant to the current policy debate, and show evidence that some provisions in labor legislation intended to protect workers may indeed end up being a cause of lower employment rates.