

International  
Labour  
Organization

## Executive Summary

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### **In defence of labour market institutions: Cultivating justice in the developing world**

Edited by Janine Berg and David Kucera

Are labour market institutions to blame for the poor economic performance of many developing countries? The prevalent view is that they are. This is based on a simplistic theory of the workings of labour markets, with the intersection of demand and supply curves for labour determining “market-clearing” levels of wages and employment. In this view, labour market institutions – however well-intended – are but sand in the machinery, sources of labour market rigidity. *In defence of labour market institutions* brings to this debate fresh and alternative perspectives, both theoretical and empirical. Compiling chapters by an interdisciplinary group of researchers, the volume is addressed to a wide range of readers with a stake in this debate, including policy-makers and academics.

*In defence of labour market institutions* considers labour market institutions in their full array, ranging from formal labour market regulations and policies to informal values and norms, but also labour markets as institutions in themselves. A defining quality of the book is its emphasis on the historical evolution of labour market institutions, which commonly arose as the outcome of social partnerships among governments, workers and employers. The volume endeavours to counter an imbalance in this debate, which has focused excessively on the unintended consequences of labour market institutions. From this perspective, labour market institutions are thought not only to hinder economic performance but in fact harm those they were meant to help. The volume does not shy from addressing such unintended consequences, particularly regarding evidence from recent empirical studies. But it also gives due weight to *intended* consequences, and finds that labour market institutions very often serve the purpose they were meant to serve, not only for the benefit of workers and their families but also for the broader objective of social justice.

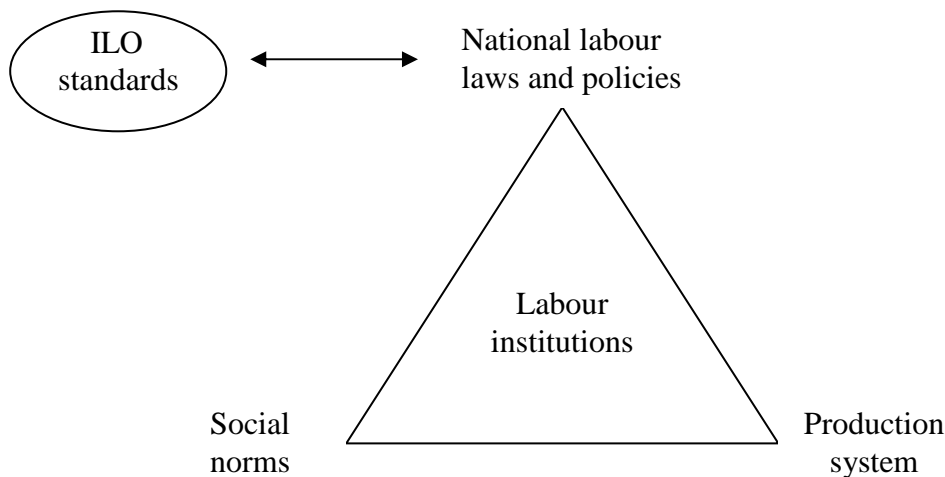
The volume is organized into several themes: the debate on labour market flexibility; historical and theoretical perspectives on labour institutions; in-depth studies of specific labour institutions; minimum wages and wages in general; the impact of unions and collective bargaining; and legal perspectives on formal and informal employment.

## The labour market flexibility debate

The debate on labour market flexibility runs throughout the volume, with several chapters providing surveys of the empirical evidence on the impact of labour market regulations on economic performance. Given what is at stake for workers in developing countries, those favouring weakening labour market regulations ought to proceed only from the foundation of a high standard of consistent evidence. This volume finds that this standard has not been met. Indeed not even a low standard has been met. The volume also notes disquieting cases in which researchers' "priors" have led to biased reporting of empirical findings. The lesson is that readers should be cautious of taking the summaries and conclusions of such studies at face value.

## Historical and theoretical perspectives

*In defence of labour market institutions* provides historical and theoretical perspectives on both market and non-market labour institutions, situating them in a context of country-specific production systems, norms, labour laws and policies.



**Figure 1: Determining labour institutions**

The International Labour Organization's (ILO) Conventions and Recommendations have been of great importance in guiding national labour laws and policies. The volume tells the story of the nineteenth and early twentieth century social movements advocating international labour standards, leading to the creation of the ILO in 1919. Key events in the history of the ILO are also traced, including the Declaration of Philadelphia of 1944 and the Declaration of Fundamental Principles and Rights at Work of 1998, as well as the ebb and flow of the ILO's influence in the context of the Cold War and the current era of globalization. The book argues that globalization has made more relevant than ever the labour standards created by the ILO's tripartite constituency of governments, workers and employers.

## **Labour institutions in depth**

Labour institutions concerning working hours, worker training and unemployment insurance systems are among those considered in depth in this volume. Provided is a critique of the World Bank's influential indicator of working time regulations, which ignores fundamental distinctions in regulations and does not tell us about actual working time. In order to overcome these limitations, the volume offers an alternative indicator of working time, based on legislated hours and observance rates for legislated hours. Working training systems are addressed through a theoretical model that is applied to two case studies of informal training systems in sub-Saharan Africa. Building on the insights of new institutional economics, the theoretical model provides an explanation why one of these cases is a success and the other a failure. Analysing the historical development of unemployment insurance systems in developed countries provides a sense of whether today's developing countries are ready to adopt such systems. The volume argues that many middle-income developing countries are well suited to the adoption of unemployment insurance or other programmes of compensation in the case of job loss.

## **Wages**

Wages are a key channel through which labour market institutions are thought to affect economic performance. In particular, wage floors can be created by collective bargaining agreements, unemployment insurance benefits (argued to raise the "reservation wage"), and through minimum wage policies. The volume provides an overview of minimum wage setting institutions around the world, using an ILO database on minimum wage legislation in more than 100 countries, and also surveys the empirical evidence on the effects of minimum wages on employment. Main findings are that the negative effect of the minimum wage on employment is often overestimated by standard quantitative methods, while its positive effects in reducing wage inequality, sustaining the demand for goods and services and contributing to social cohesion tend to be ignored. The volume also provides a critique of the most widely used theory of wage and employment determination, specifically the downward sloping demand curve for labour. The argument is that the theory is irreparably flawed at its foundations, raising fundamental problems with interpretation of empirical evidence regarding the purported effects of wages on employment.

## **The impact of unions and collective bargaining**

The volume provides a comprehensive review of the empirical literature on the economic effects of unions and collective bargaining, summarizing over 1,000 published studies. This survey concludes that the effects of unions and collective bargaining are too multifaceted to permit simple positive or negative conclusions. The effects depend on the extent to which a country is engaged in global markets and how collective bargaining is coordinated, among other factors. The volume also empirically evaluates whether stronger trade union rights and higher wages in formal employment give rise to more informal employment. The strongest finding of this analysis is that stronger trade union rights are, in fact, associated with higher shares of formal employment.

## Legal perspectives

The debate on labour market regulations has been dominated by economists. Yet economists have much to learn from lawyers regarding what the implementation of labour law means in a concrete sense. The volume offers legal perspectives on two issues: informal employment and labour law reform. Regarding informal employment, the volume addresses legal and socioeconomic definitions, making the distinction between informality due to the limited scope of legal coverage versus outright illegality. The distinction provides an essential starting point for developing countries to mitigate informality, since labour administration systems are based solely on the legal definitions embodied in a country's labour code. The volume provides a critical assessment of the labour law reforms that took place in Latin America in the 1990s. The main findings are that a good number of the reforms were ill-conceived, as evidenced by the counter-reforms that have since taken place. Moreover, the reforms failed to achieve their stated objective of creating employment.

## Policy conclusions

Good policy-making is as much about what not to do as what to do. Deregulating labour markets is not the solution to the poor economic performance of many developing countries. The solutions lie outside the realm of labour market regulations and involve development policy more broadly, particularly regarding macroeconomic policy, development of the domestic market and strategic engagement with the global economy. This volume provides an important contribution to these debates, shedding light on potentially dangerous paths as well as affirming the value – both social and economic – of “good” labour institutions and regulations.

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