Update: Labour Market Deregulation Measures in IMF Loan Conditionality and Policy Advice for European Countries
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Introduction

1. Most of the IMF loan programmes and policy advice for European countries in economic difficulty have had a heavy focus on labour market reforms, all going in the direction of reducing regulations and decentralizing collective bargaining. The measures taken so far have led to a sharp drop in collective bargaining coverage and contributed to the lack of recovery through compression of aggregate demand. In the longer run, even if one believes the IMF's optimistic projections about the impact of labour market deregulation, the measures will have no more than a slight impact in improving countries' growth rates. However by reducing workers' protection and bargaining power they will worsen income inequality. The severe weakening of collective bargaining institutions will also make it difficult or impossible to develop the cooperative approaches for overcoming the crisis and creating jobs that proved successful in other European countries.

2. The IMF should recognize the damage that its approach on labour market reforms in Europe is causing both in the short and longer terms, especially as regards the impacts for worsening inequality, which recent IMF research shows will lead to greater economic instability and lower growth. The IMF should support a strengthening of labour market institutions that will contribute to a more sustainable and cooperative approach for economic recovery.

IMF European Department's Approach

3. Loan conditions or recommendations for labour market reforms became a major feature in loan programmes or policy advice for European countries in economic difficulty starting in 2010; in some countries they started earlier. Examples for six countries are presented below. In June 2012 the IMF's European Department released a paper, *Fostering Growth in Europe Now* that presents the rationale behind the Fund's approach in Europe. The paper has been cited by the IMF as showing that "large-scale reforms of labor, product and service markets could boost GDP by 4½ per cent over five years" in euro-zone countries and that the reforms "should be implemented without delay" (*IMF Survey Online*, 18 June 2012).

4. What the paper actually states about the impact of labour market reforms is considerably more modest and nuanced than what the statement in

the previous paragraph implies. *Fostering Growth in Europe Now* presents the following findings:

- In the short run, labour market reforms may actually increase unemployment, for example when dismissal costs are reduced and firms shed labour;
- Reforms need to be complemented by policies that boost aggregate demand if they are to increase growth potential;
- Even in the longer run, labour market reforms will only have a small impact on growth, 0.5 per cent after five years according to a figure on page 15 of the paper;
- The paper mentions reforms' "potentially high social costs" but does not quantify these nor does it discuss their impact on inequality.

5. The *Fostering Growth in Europe Now* paper contains an Annex 1 that presents colour-coded "Structural Reforms Gaps" with OECD benchmarks for ten euro-zone countries, including most of the crisis countries. Not a single country is identified as having as having a "red" (large) gap for labour regulations, that is employment protection regulation; in fact none larger than Germany's. Some of the largest gaps identified are in the areas of legal institutions, infrastructure, training, goods market efficiency, credit markets and innovation. It may be added that the assessment of IMF research that labour market deregulation measures would have an insignificant or modest impact on growth concurs with findings of the World Bank's *World Development Report 2013: Jobs* and the OECD's *Divided We Stand* (2011).

6. Despite acknowledging the limited importance of labour market issues relative to others, *Fostering Growth in Europe Now* asserts that reforms are required "in particular" in labour markets. They are also at the top of the agenda in almost all of the 17 countries for which detailed proposals are presented (Annex 2), which it states are based on "IMF recommendations on reform priorities for each country". There is a clear divorce between IMF analyses of the relatively minor obstacles to growth created by labour regulations and institutions, and the emphasis on labour market deregulation in IMF country programmes and policy advice. Additionally, no attempt is made in the paper to assess the impact on inequality or social cohesion in the longer run of reforms that weaken collective bargaining institutions. Some recent examples of labour market reforms recommended in IMF country reports follow.

Spain

7. The IMF's Article IV reports for Spain have attributed the sharp drop in employment relative to a milder decline of GDP to rigidities of wages and

working conditions and duality in the labour market. It would have been helpful if the IMF had paid attention to the main cause of Spain's crisis: the collapse of the labour-intensive construction sector after the bursting of the debt-fuelled real estate bubble. The reports overstate the role of labour market rigidities and ignore the challenge of recycling huge numbers of construction workers into other sectors. The reports' calls for an end to wage indexation, lower wages and decentralized collective bargaining will contribute to further compression of demand and increase wage dispersion and inequality.

8. Identifying centralized bargaining as a source of "rigidity" is inaccurate. In fact, trade unions have shown a great degree of flexibility, agreeing to suspend indexation of wages in 2010 and 2012. The 2013 Article IV report acknowledges that "wages in the public sector and large firms have fallen". The same report blames industry-wide collective agreements for the fact that hours per employee increased since 2007, but in fact no increase of working hours was negotiated. The increase of hours is due to employers' prerogative and would seem to justify stronger agreements to limit overtime and reduce working hours. However agreements to reduce working hours in other countries, for example in Germany at the start of the 2008-2009 crisis, have only succeeded through widespread sector-level bargaining, precisely what the IMF wants to eliminate in Spain.

9. The 2013 Article IV report called for "an agreement between workers and unions [with] employers committing to significant employment increases in return for unions agreeing to wage reductions". Assuming such an agreement is an appropriate response to current circumstances, the IMF does not explain how this can be achieved if collective bargaining, as is the Fund's aim, is completely decentralized. Only in countries with highly coordinated collective bargaining have similar agreements been negotiated and implemented throughout the economy.

10. The IMF has argued that lower wage costs are necessary in order to "rebalance" the European economy as a whole by making countries such as Spain more competitive. Spain's current account is now in surplus, although this is in part due to a recession-induced decline of imports. But in 2012 the EU accounted for just 67 per cent of exports versus 73 per cent in 2007, showing that the intra-European rebalancing has not yet taken place and probably impossible to achieve in a context of continued stagnation across the region. The IMF forecasts that domestic demand in Spain will continue to shrink until the end of 2016.

11. On 1 April 2014 the ILO's Committee on Freedom issued a finding that Spain's reformed 2012 labour law violated freedom of association and collective bargaining rights: "The elaboration of procedures systemically favouring decentralized bargaining of exclusionary provisions that are less favourable than the provisions at a higher level can lead to an overall destabilization of the collective bargaining machinery and of workers' and employers' organizations and constitutes in this regard a weakening of freedom of association and collective bargaining contrary to the principles of Conventions Nos 87 and 98."

12. The IMF should support a restoration of collective bargaining rights that respect international principles and that encourage the use of sector or regional bargaining with the objective of achieving working-time reduction and new hiring agreements between unions and employers. In addition, the IMF should ensure that the pace of fiscal consolidation does not lead to further compression of aggregate demand and force Spain back into recession.

Portugal

13. IMF's first loan report for Portugal in May 2011 acknowledged that the "front-loaded" fiscal adjustment programmes would suppress domestic demand and contribute to recession and that the "payoff" from structural reforms would only come gradually. Later, in October 2012, the IMF admitted that fiscal multipliers in Portugal have been higher than previously estimated, meaning that the recessionary impact of austerity policies was stronger than they expected.

14. The Fund's reports encouraged a weakening of sector-level bargaining despite their recognition (April 2012) of a "promising agreement" between social partners and the government that made working time more flexible, reduced overtime pay, reduced paid holidays, eased restrictions on dismissals for redundancy and reduced unemployment benefits and severance payments. Another report, in July 2012, stated that "labor shedding has been accompanied by more wage adjustment than expected".

15. Decentralization of collective bargaining took place, as noted in IMF reports issued in 2013, with the power of negotiation delegated to works councils (rather than trade unions). But in November 2013 an IMF report insisted that "more effective decentralization of wage bargaining was needed" and in January 2014, another report complained about "downward wage rigidity" (contrary to what had been stated in July 2012; see Paragraph 14).

16. However a New York Times article stated in December 2013 that collective bargaining coverage in Portugal had fallen from 1.9 million in 2008 to

300,000 in 2012. If indeed the strong majority of workers are no longer covered by collective agreements, the “downward rigidity” of wages that the IMF deplores must be due to other factors. The collapse of collective bargaining coverage should be of particular concern to the IMF because Portugal now has the third highest level of income inequality in the EU, according to a 2013 ILO report.

17. In any case, Portugal’s external trade balance on goods and services moved into surplus in 2013 and is expected by the IMF to reach 3.0 per cent of GDP in 2014 (up from a deficit of 7.2 per cent in 2011), which would seem to indicate that external competitiveness is no longer an issue. On the other hand, the lack of domestic demand continues to be a problem. The IMF predicts that private consumption will increase by only 0.1 per cent in 2014 while public consumption will continue to decline because of austerity measures, such that compressing wages further will certainly not help sustain a recovery.

18. As in Spain, the IMF should support a restoration of collective bargaining rights and institutions that encourage the use of sector or national bargaining with the objective of achieving viable agreements on wages and working conditions between unions and employers. In addition, the IMF should ensure that the pace of fiscal consolidation does not lead to further compression of aggregate demand and force the Portuguese economy back into recession.

Greece

19. The IMF’s loan programme in Greece, which began in May 2010, has been a story of one failed adjustment package after another with workers as the main victims, something that the most recent IMF reports have acknowledged. The first loan report in 2010 announced that unemployment would “peak at nearly 15 per cent in 2012”; in fact by late 2013 the unemployment rate reached almost 28 per cent. The government acceded to IMF demands for more flexible wage-setting mechanisms and a “less rigid labor market”, even though the initial loan document (May 2010) stated that the level of wages in the private sector was not a major problem.

20. In December 2011, however, the IMF called for greater wage flexibility and the government took the decision to suspend the extension of sector-level agreements. By March 2012 the IMF stated in a loan report that hourly wages had fallen by 10-12 per cent over the previous two years. Despite that, it called for further labour market liberalization and “nominal wage reductions”, and endorsed the government’s decision to reduce the minimum wage by 22 per cent (32 per cent for those under age 25). The same report stated that wage

reductions had contributed to the "deep recession [which] works directly against efforts to improve the fiscal position and financial stability" and that "labor market reforms … represent a drag in the near term, as incomes fall".

21. The March 2012 IMF report also acknowledged that the idea of achieving "internal devaluation" – aimed at making the Greek economy more competitive within the euro zone – without major job losses was a pipe-dream: "Private sector corporations are more likely to cut employment than to fully adjust wages, even in fairly flexible labor markets (Latvia)."

22. In June 2013, the IMF acknowledged in an Article IV report that there "has been the weak and delayed response of prices to wage reductions [which] has led to a substantial erosion in real incomes and demand and placed a disproportionate burden on wage earners relative to the self-employed and the corporate sector". The report could have added the impact in terms of unemployment and the destruction of collective bargaining. Once complete data are available, it seems inevitable that income distribution in Greece will have become more unequal.

23. The IMF should encourage a return to sector-level bargaining with the object of encouraging new hiring, in part by limiting working hours. It should also ensure that workers no longer assume the main burden of adjustment measures and rebalance towards, for example, more progressive taxation.

Romania

24. The IMF has been encouraging Romania to undertake labour law reforms for at least a decade in Article IV and loan reports. On at least two occasions, including as recently as 2010, the IMF invoked Romania's labour market "rigidity" as measured by the *Doing Business* labour market index, even though the World Bank suspended this index because of methodological problems and told its own staff to stop using it in 2009.

25. In 2011 the Romanian government enacted a new Labour Code and Social Dialogue Code, which the IMF welcomed in a June 2011 loan report because they would make employment contracts, working hours and the wage-setting process more flexible. However the IMF acknowledged that the new social dialogue law – which abolished national bargaining, severely restricted sector bargaining and also created new obstacles for firm-level bargaining – was "controversial".

26. The new law resulted in a sharp drop in collective bargaining coverage. The ITUC's Romanian affiliates estimate that coverage fell by two-thirds between

2010 and 2013. In addition, the ILO's Committee of Experts on the Application of Conventions and Recommendations issued an observation in 2012 that the 2011 law violated ILO Convention 98 on the Right to Organize and Collective Bargaining.

27. In mid-2012 a new coalition government in Romania announced its intention to modify the 2011 labour laws so as to facilitate collective bargaining and comply with international labour standards, and engaged in consultations with the social partners for this purpose. The government prepared changes to the law that had been agreed by the trade union centres and most business organizations, with the exception of the American Chamber of Commerce in Romania. The IMF and European Commission objected to the proposed changes and informed the government in writing (their position was leaked to the ITUC). Among other points, the IMF and EC objected to a restoration of national wage bargaining, wished to reduce protections of union representatives against firing and wanted to place limits on the right to strike.

28. In a July 2013 loan report the IMF reiterated that the government should resist "efforts to undo progress made in labor law legislation" and implied that no changes to the 2011 laws should be made unless they had the consent of "all stakeholders". Given the support for the 2011 laws from the American Chamber, the Fund essentially told the government it should grant the latter a veto right and not change the law. It is worth noting that the IMF expressed no such stipulation about the need for unanimous consent for the 2011 labour law revisions, which were strongly objected to by all the trade union centres and also some employers' organizations.

29. Pressure from the IMF may explain why the government abandoned its plans to revise the 2011 social dialogue law, thus leaving intact those provisions that violate Convention 98. Shortly after the government dropped its amendment plans, the IMF announced a renewed loan to Romania in September 2013. The IMF's latest loan report (April 2014) states that the government plans to renew the social dialogue law by end-2014, but the IMF has not indicated whether it will change the stance it enunciated in 2012 and 2013 of opposing a restoration of national and sector bargaining.

30. The IMF should cease its objections to changes to the labour and social dialogue laws that the government tried to implement in 2012 and encourage the government to move quickly to correct the laws' provisions, particularly those that violate international labour standards and are responsible for the collapse of collective bargaining. The drastic decline in bargaining coverage

experienced by Romania will not reverse itself until the changes are made, with intensifying impacts on wage dispersion and inequality.

Serbia

31. Until the latter part of 2011, labour aspects of IMF reports for Serbia (which is not an EU country, therefore there is no Troika involvement) have been mainly focused on the country's pension system, which the IMF considers overly expensive, and on public-sector wages, which it says exceed private-sector wages. A loan report in January 2011 notes that "low wage growth, while good for rebalancing the economy, was [constraining] fiscal revenues"; national collective bargaining had already been eliminated by that time.

32. Without providing detail, a second IMF loan report issued that year, in October 2011, took aim at private-sector labour market institutions and asserted that "the labor market needs to be made more flexible". In July 2013 the Fund called for a long list of labour market reforms: lower severance pay, slowing of minimum wage increases, easier dismissal processes, "more flexible wage bargaining and employment procedures".

33. In February 2014, one of the ITUC's Serbian affiliates learned from government sources that the IMF wished to abolish sector-level bargaining, and that this should happen after national elections held in mid-March. Serbia is currently engaged in negotiations for renewing its IMF loan. There has been no public confirmation from the IMF that it intends to demand a government commitment to abolish sector bargaining, but it would certainly be consistent with what it has promoted in Greece, Portugal, Spain and Romania.

Germany

34. Germany emerged relatively unscathed from of the crisis, enjoying a huge trade surplus and not requiring IMF support. But it interesting to examine IMF labour market recommendations for Germany over the past several years because they show a remarkably similar pattern to what one sees in the crisis countries: end of "burdensome" labour regulations, more fixed-term contracts, more flexibility, easier firing rules, decentralized collective bargaining, greater wage differentiation and, until recently, wage moderation and opposition to a minimum wage. They give the impression that the IMF truly follows a "one-size-fits-all" approach as far as labour issues are concerned.

35. Presciently, German government representatives told the IMF in 2000, as reported in an Article IV report, "that a sustained strategy of wage moderation in

Germany could in the medium term result in diverging labor cost developments in the euro area countries, with attendant problems for formulating a euro-area wide monetary policy." The report shows that the IMF mission ignored this warning.

36. Instead, Article IV reports in 2001, 2002, 2003, 2004 and 2006 harped on the need for more wage moderation, and other deregulatory measures such as more fixed-term contracts, more flexible hiring and firing and "reducing remaining central controls on wage bargaining". In 2006 the IMF report added that "minimum wages [which were then under consideration] would be a serious policy error". This was repeated in 2008 when IMF staff are cited in an Article IV report as cautioning the government about "a misplaced focus on minimum wages".

37. In July 2011, almost three years into the global crisis and by which time several euro-zone countries were in severe economic difficulty, the IMF told the government that "raising German wages [was] neither analytically nor pragmatically sound". The IMF finally relented a year later, four years into the crisis, and timidly agreed that "a pick-up in wages … should be seen as part of the process of private sector-led rebalancing" (July 2012 Article IV report). In August 2013, the IMF's report for Germany stated that "it would not be inappropriate for real wages to rise, and therefore help improve the labor share of national income". However the IMF has yet to express approval for the government's announced intention to adopt a minimum wage, which would make Germany one of the last advanced-economy countries to do so.

38. The IMF's promotion of wage moderation, weakening of employment protection rules and decentralized collective bargaining contributed to the declining labour share in national income and reduced collective bargaining coverage in Germany. Fortunately the IMF did not succeed in dismantling the basic structure of sector-level bargaining, and the adoption of widespread reduced working time agreements ("Kurzarbeit") through sector agreements was subsequently credited, even by the IMF, as having played an important role in preventing a sharp increase of unemployment during the 2008-2009 recession. But the IMF's persistent encouragement of Germany to reduce labour costs and increase its export competitiveness as the expense of other European countries was undoubtedly a factor contributing to the serious imbalances within the euro area that came to the fore after the 2008 financial crisis.

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