The IMF’s Advice on Labor Market Issues

The IMF’s Articles of Agreement commit the institution to “the promotion and maintenance of high levels of employment and real income.” This commitment has been reaffirmed over the years, with IMF management often stressing the importance of employment for social cohesion. In the wake of the global economic crisis, unemployment rose sharply in many countries, heightening the need to create conditions for job creation and inclusive growth.

The global economy experienced the most severe case of unemployment during the recent economic crisis—the worst since the Great Depression—and unemployment remains high today. Unemployment is highly dependent on economic activity. In fact, in the short run, growth and unemployment are two sides of the same coin: when economic activity is strong, there is more production, and more people are needed to produce greater amounts of goods and services. And when economic activity is weak, companies reduce their workforce, and unemployment rises.

In the longer run, a broader set of policies and institutions influences the functioning of labor markets and the extent of job creation. Often, changes in policies and institutions are needed to boost growth and job creation. Such changes can be politically contentious and difficult to implement. In extreme cases, it may be necessary to lower labor costs. But for some countries, reform is essential to restore competitiveness and create greater job opportunities in the future—especially for younger workers. If such reforms are undertaken, they should be implemented according to individual country circumstances, and with care, especially for the most vulnerable members of society.

Active partnerships

Labor market policies feature in the IMF’s policy advice and programs because of their importance for job creation and growth. In order to ensure a comprehensive approach to labor market issues, the Fund draws on the expertise of other international, regional, and national organizations.

The IMF has an active partnership with the International Labor Organization (ILO). The two institutions pool expertise for better understanding the impact of macroeconomic policies on job creation, including through joint research and analytical support for the Group of Twenty industrialized and emerging market economies. Cooperation with the ILO has also produced joint work on social dialogue involving governments, unions, and employers in three pilot countries (Bulgaria, Dominican Republic, and Zambia) and work on social protection floor policies.

The IMF also works with the World Bank on labor market issues, and with regional organizations, such as the European Commission. At the country level, more than 80 percent of IMF missions meet with national trade union representatives to exchange views on what is happening in the labor markets of individual IMF members, and there are extensive policy consultations with the International Trade Union Confederation.

The IMF has increased its efforts to draw on the expertise of partner institutions to enhance coverage of macro-social issues in the Fund’s policy analysis and advice. For example, Fund research on growth, employment, inequality, and poverty are being strengthened in consultation with external partners, and supported by an interdepartmental working group on jobs and growth.
Overview of the IMF’s engagement

The IMF’s advice on labor market institutions and policies is aimed at reducing unemployment rates and generating inclusive growth. Strong labor market institutions will allow workers to go to where they are needed most, while providing support to those for whom this process comes at a cost. This balance is difficult to achieve, but active labor market policies (e.g., training), as well as employment protection legislation, minimum wages, and collective bargaining institutions have important roles to play in helping to reach these goals.

However, these goals need to be carefully balanced. For example, while employment protection can help level the playing field in terms of bargaining between firms and workers, too high a level of protection—or differing levels of protection across employment groups (e.g., permanent versus temporary contracts)—can lead to labor market distortions where some groups, such as the young, end up with very high unemployment rates.

- In its bilateral surveillance, the IMF examines labor market issues, especially in cases where these issues are critical to countries’ macroeconomic stability.

- In IMF-supported programs focused on short-term macroeconomic stabilization, recommendations about monetary and fiscal policies play a greater role than advice on labor market institutions, reflecting the limited role that labor market policies play in driving short-run macroeconomic outcomes.

- In IMF-supported programs focused on longer-term economic adjustment, the focus is often on boosting growth as the main engine of employment creation, and making it more inclusive. Many recommendations relate to fostering private sector activity, for instance through improving the investment climate, broadening access to financing, increasing competition in product and service markets, and/or diversifying the economy. In addition, active labor market policies—in particular vocational training and educational programs for workers—often have a positive role to play.

Difficult tradeoffs to restore growth and competitiveness

The IMF’s advice on labor market issues is tailored to each country’s circumstances. In Europe, for instance, several countries are currently faced with the challenge of having to regain competitiveness to boost growth. Because eurozone membership implies that the nominal exchange rate cannot be devalued and interest rates cannot be adjusted in an individual country, and because productivity increases only take hold over time, improving competitiveness may require a reduction in costs, including labor costs.

In Greece, unemployment has increased sharply since the 2008 global financial crisis, exceeding 27 percent in mid-2013. As a member of the eurozone, Greece cannot devalue its currency. This means it needs to close its competitiveness gap by other means until reforms to improve productivity produce results.

Unit labor costs—a key measure of competitiveness—increased by over 35 percent in Greece during 2000–10, compared to less than 20 percent in the euro area as a whole. At end-2011 Greece’s minimum wage was substantially higher than that of its closest competitors—50 percent higher than Portugal, and 17 percent above Spain, for instance. This is one of the reasons why Greece’s exports of goods and services amounted to only about 20 percent of GDP in 2010. To help restore competitiveness, the minimum wage was reduced by 22 percent in February 2012, with a further 10 percent reduction for youth. In addition, the IMF-supported program targets a budget-neutral reduction in non-wage costs by 5 percentage points.
Sharing the burden of adjustment

Labor market reforms such as those being implemented in Greece have wide-ranging social consequences. Maintaining social cohesion through such wrenching change is key to engineering a successful economic recovery. This should be achieved through extensive consultation between all social parties, including trade unions. The adjustment must be seen as fair, and as involving not just labor, but also product and service markets and the financial sector. But adequate burden sharing depends on a willingness of all social partners to consult.

It is also important to have a social safety net in place to protect the most vulnerable in society. In Europe, the IMF has worked closely with the World Bank and the European Commission to protect social spending and jobs, where possible, even when overall spending has to be cut.

Latvia is one such example. The economic downturn in 2008 and 2009 was severe, and the unemployment rate peaked at around 20 percent in early 2010. Unemployment has since fallen below 12 percent, in part due to emigration, but also because new jobs now are being created. The IMF strongly supported the government’s introduction of an emergency public works program, financed by the European Social Fund, to provide temporary jobs to people who wanted to work but were unable to find employment. The Fund also worked closely with the World Bank to find ways to protect the poor. Under the IMF-supported program, the government increased guaranteed minimum-income payments, abolished healthcare co-payments for the most vulnerable, increased funds for emergency housing support for low-income households, and protected schooling for 5–16 year olds.

Latvia’s IMF-supported program was successfully completed in December 2011. Since then, the IMF has encouraged the government to devise ways to make the safety net permanent and strengthen it through better targeting of social assistance and progressive tax policy without distorting work incentives.

Making room for critical social and infrastructure spending

IMF-supported programs may support reductions in the government wage bill burden (its share in GDP), which affects public sector workers. Typically, such measures are supported when the wage bill has been increasing to unsustainable levels, wages are substantially out of line with those in the private sector, or government employment is greater than in comparator countries. An important motivation for containing the public sector wage bill is to create fiscal space for critical social and investment spending.

In some cases, wage bill cuts are implemented to return public finances to a sustainable position and free up resources for private sector activity. Wherever possible, such measures are accompanied by provisions to protect the poorest public workers.

In Jamaica, for instance, under the Fund-supported program the government aims to reduce public sector wage costs from 11 percent of GDP to no more than 9 percent over the medium term. At the start of the arrangement, in May 2013, this reform was supported by a multiyear wage agreement with the unions. For the medium term, to the program foresees a range of reforms to modernize the public sector and enhance its quality and efficiency.