

Involvement of the International Monetary Fund in Labour Market Reforms in European Countries *ITUC Background Paper February 2013*

Executive Summary

Since the beginning of the global economic crisis in 2008 the IMF has paid increased attention to the employment impact of different policy measures, particularly in research studies it has carried out. Some of the IMF research examined the effect of labour market regulations on employment and, consistent with recent research reports from the OECD and World Bank, found no or very modest impact. One study produced by the IMF's European Department in 2012 was more assertive about the benefits of labour market deregulation, but was generally consistent with the others in agreeing that any positive impact would be modest and medium-term, and that the employment effects would be negative in the short-term. This study did not identify a single European country where labour market regulations were an important impediment to growth, but did identify several with important non-labour obstacles, such as deficiencies in infrastructure, education systems and financial markets.

Despite the lack of evidence-based justification for seeking major deregulatory reforms of labour market institutions, this paper finds that they have been a major focus of IMF programmes and policy advice in almost all of the nine European countries examined in detail. The advice and programme conditions have included weakening or dismantling of job-security protections and national or sector-level collective bargaining arrangements with the objective of making the workforce more "flexible" and obtaining "wage moderation". The deregulatory policy recommendations have been applied by the IMF indiscriminately in EU countries experiencing current-account deficits and financial and economic difficulty and in countries with high current-account surpluses, resulting in serious negative consequences. In particular, by repeatedly advising Germany to practise wage moderation and not to introduce a minimum wage in order to make its economy more "competitive", the IMF rebuffed warnings cited in its country reports that these practices would contribute to the intra-EU trade imbalances that are at the root of the EU's current economic difficulties. The paper posits that IMF advice and loan conditionality to dismantle or weaken national or sector-level collective bargaining arrangements, which are important part of the IMF's policy recommendations in most of the EU-country cases examined in this paper, hamper the implementation of measures needed to mitigate or overcome the crisis. Coordinated collective bargaining institutions played a significant role in avoiding an increase in unemployment or in rapidly reducing it in the last two country cases considered. Only in one of them, the non-EU country of Iceland, does the IMF acknowledge the critical role played by centralized collective bargaining and the involvement of trade unions more broadly in developing a successful anti-crisis strategy.

Introduction

After the outbreak of what it called the "Great Recession" of 2007-2009, the International Monetary Fund began to pay greater attention to the challenge of unemployment than it had previously, at least in public statements and publications. In a report produced for a joint conference with the International Labour Organization held in Oslo in September 2010 on "The Challenges of Growth, Employment and Social Cohesion", the IMF noted that the global number of unemployed had increased by more than 20 million. It described how even a temporary spike in unemployment would cause long-term economic and social damage.¹

The IMF paper spoke positively of measures that many countries were adopting to reduce the problem of unemployment and mitigate the damage: (1) support for aggregate demand; (2) programmes to reduce the impact of unemployment, such as reduced work-time and provision of unemployment benefits; and (3) acceleration of the jobs recovery through measures such as wage subsidies or payroll tax holidays.²

The IMF background paper at the Oslo conference observed that three-fourths of the increase in global unemployment had taken place in "advanced" economies. More than any other region, Europe suffered from the global economic downturn and its resulting impact of high and persistent joblessness. Because of the crisis several European countries also became recipients of IMF loans after the global recession began; a total of sixteen European countries contracted new IMF loans starting in 2008. Many of these loans included conditions concerning reforms in labour market institutions and social programmes.

However, with the exception of some provisions aimed at "protecting the most vulnerable", the loan programmes did not include the type of measures listed by the IMF at the Oslo conference as policies that would have a positive impact in reducing unemployment and its costs. The reform measures adopted in fact usually had the

¹ IMF and ILO, *The Challenges of Growth, Employment and Social Cohesion: Discussion Document,* Oslo, 2010

² Ibid, p.16

avowed aims of making economies more "competitive" or reducing budget deficits, or both. It is highly likely, according to studies carried out by various researchers including those at the IMF, that labour market and social programme reform measures of the kind adopted in several European countries have in fact accentuated problems of unemployment and decreased living standards, at least in the short run.

This background paper examines recent recommendations for labour market and social programme reforms in nine European countries. Five of these countries – Greece, Iceland, Ireland, Portugal and Romania – contracted IMF loans starting between 2008 and 2011. A sixth country, Bulgaria, has borrowed from the Fund almost constantly since the early 1990s but its last lending agreement ended in March 2007. One reason for including Bulgaria for consideration in this paper is that it is one of three "pilot countries" (the other two are non-European) chosen by the IMF and the ILO for a joint initiative on job-focused growth in follow-up to the 2010 Oslo conference. The last three countries considered here, Spain, Italy and Germany, have not had IMF lending programmes for decades, but we have included them because IMF recommendations have concentrated heavily on labour market reforms, either in response to the current economic crisis or in the years leading up to the crisis.

Before examining labour market and social programme reform measures proposed by the IMF for the nine European countries, we briefly review some recent research and policy pronouncements made by the IMF on labour market and social programme issues in general, as well as analyses produced by other multilateral economic institutions. In several cases, the specific policy proposals or loan conditions described for each country appear to be at odds with the research conclusions issued by the IMF and other institutions.

IMF research on crisis, unemployment and labour market reforms

Since the beginning of the global financial and economic crisis in 2008 IMF researchers have produced several working papers highlighting the negative consequences on working people of certain policy choices. Some of this research work and research on the same theme carried out by academic economists were summarized in an article published in the IMF's quarterly magazine *Finance and Development*, of which the September 2011 issue was devoted to the theme of inequality:

"The research described here shows that it is important to have realistic expectations about the short-term consequences of fiscal consolidation: It is likely to lower incomes – hitting wage-earners more than others – and raise unemployment, particularly long-term unemployment."³

³ Ball, Leigh and Loungani, "Painful Medicine" in IMF, *Finance & Development*, September 2011, p. 23

Another article in the same guarterly focused on the increased domestic and foreign indebtedness associated with higher income inequality in advanced economies, a situation which the article considered to be inherently destabilizing. It put forward some policy approaches for reducing income inequality so as to reduce its destabilizing effects:

"On the taxation front, solutions might include more progressive income taxes that leave average tax rates unchanged ... [or] appropriately designed taxes on profits from investments, land, natural resources, and the financial sector.... [Other solutions could include] strengthening the bargaining power of workers".⁴

In March 2012 the IMF released a Working Paper on the themes of financial crisis, unemployment and labour market flexibility. The authors of the paper concluded, on the basis of statistical analyses of the impact of reforms to create more flexible labour markets, that such reforms "may reduce unemployment, albeit only in the medium term" (emphasis added). However they cautioned that they had not investigated "the possible short-term effects" of deregulatory reforms on "ineguality and job destruction".⁵ The implication of this IMF research was that there was likelihood that in the short run the reforms could actually increase unemployment.

In June 2012 the IMF's European Department issued a Staff Discussion Note entitled "Fostering Growth in Europe Now", which was more assertive than those cited above about the beneficial effect of labour market deregulation. According to a summary of the paper's conclusions published by IMF Survey.

"Because structural reforms deliver their potential gradually, product and services market reforms, as well as labor market and pension changes, should be implemented without delay. The analysis shows large-scale reforms could boost GDP by 4¹/₂ percent over five years."⁶

However a reading of the 43-page paper used to justify these claims shows that the positive impact of substantial structural reforms would happen only if several major and parallel economic policy shifts take place throughout the euro-zone, and even so would entail a short-term increase in unemployment and "potentially high social costs":

⁴ Kumhof and Rancière, "Unequal=Indebted" in IMF, Finance & Development, September 2011, p. 27

⁵ Bernal-Verdugo, Furceri and Guillaume, Crises, Labor Market Policy, and Unemployment, IMF, March 2012, p. 18. It may be noted that this paper's analysis is largely based on indicators of labour market flexibility taken from the World Bank's Doing Business report. The use of these indicators is questionable in view of the fact that in 2009 the World Bank suspended their publication and advised its staff that the Doing Business labour indicators should not be used in recommendations, strategies, policy notes or analytical work (see: World Bank, Guidance Note for World Bank Group Staff on the Use of the Doing Business Employing Workers Indicator for Policy Advice, October 2009). The IMF in 2011 created a labour market regulations database and, in the report launching it, noted that Doing Business indicators, especially the labour indicators, had been criticized for "their subjective nature" (see: Aleksynska and Schindler, Labor Market Regulations in Low-, Middle- and High-Income Countries: A New Panel Database, IMF, 2011, p. 9).

⁶ IMF Survey on Line, "Europe Needs Comprehensive Action to Revive Growth", 18 June 2012

"Several studies find that reforms have a small, and in some cases even negative, short-term effect on output and employment because of costly and timely reallocation of resources and restructuring, with a temporary rise in unemployment and potentially high social costs."⁷ (p. 13)

The predicted 4.5 per cent GDP gain is a projection that depends on economies operating at full capacity, which currently is clearly not the case, but which explains why the authors state: "Structural reforms, therefore, need to be complemented by policies that boost aggregate demand."⁸

In addition, only one-third of the gain, that is 1.5 per cent, would result from the proposed labour market and pension reforms, a gain which appears very modest when one compares this to the loss of up to 25 per cent of GDP that some European countries have suffered because of the crisis and austerity policies. In an annex on "Key Gaps in Structural Policies", the paper does not identify a single euro-zone country where it considers that "structural reform gaps" (the gap between a country and its OECD peers) in the area of labour market regulations merit what it calls a "red flag", i.e. are a large constraint on growth. The annex does identify "red flag" deficiencies in many non-labour-regulation areas: legal systems, infrastructure, education and training, goods markets, financial markets and technology.⁹

The paper also acknowledges that Germany's far-from-flexible labour market proved to be a saving grace during the global recession: "It is notable that the German labor market, which is found to have significant gaps compared to their OECD benchmarks, produced favorable employment outcomes during the crisis." ¹⁰

But the benefits of labour market regulation, and the relatively minor role that labour market factors have played in the crisis countries, are quickly forgotten when the paper defends the importance of prioritizing labour market reforms through tautological argument: "IMF recommendations on reform priorities for each country indicate that further measures are needed, in particular to improve the functioning of labor markets ...".¹¹

Despite identifying labour market issues as a relatively minor constraint on growth, more than half of the specific reform measures put forward in the IMF's European Department paper concern labour market and social programme reforms. The measures proposed include restricting early retirement and increasing retirement ages, cutting public-sector jobs, eliminating wage indexation, freezing minimum wages, dismantling or weakening

⁷ Barkbu, Rahman, Valdés, "Fostering Growth in Europe Now", IMF, June 2012, p. 13

⁸ Ibid, p. 18

⁹ Ibid, p. 33

¹⁰ Ibid, p. 31

¹¹ Ibid. p. 31

sector-level collective bargaining, reducing unemployment benefits, relaxing dismissal procedures, shrinking severance pay and reducing payroll taxes.¹²

Another IMF Working Paper published in 2012 found no evidence that, for a given level of output, labour market regulations were an important determinant of the level of employment. More specifically, it did not find that differences in employment protection legislation (EPL) could explain variations in the relationship between output and employment across countries: "This variation is partly explained by idiosyncratic features of national labor markets, but it is not related to differences in employment protection legislation."¹³

Clearly, the policy prescriptions for radical labour market deregulation, which the previously cited "Fostering Growth in Europe Now" states are needed because the IMF recommends them, are not borne out by the IMF's research in several papers produced since 2011, a period during which unemployment persisted at high levels in many countries despite the fact that the world economy was supposedly recovering from the 2008-2009 global recession.

Recent research in other multilateral institutions on the impact of reforms that increase labour market flexibility confirm the lack of evidence about the positive impacts of the reforms, including in the long run, that had previously been assumed,. The OECD, which for many years promoted the idea that reduction of EPL would enhance job creation, found no evidence for taking such a policy stance in more sophisticated recent research that it carried out. A major study it published in late-2011 on 22 OECD economies over a 17-year period found that reduced EPL, i.e. increased labour market flexibility, had no statistically significant impact on employment rates; however reduced EPL did result in higher wage inequality.¹⁴

The World Bank devoted the 2013 edition of its major annual policy research publication, the *World Development Report* (WDR) to the theme of "Jobs". The report includes an extensive review of economic literature on the relationship between EPL and other labour market regulations on the one hand and economic indictors such as employment on the other. The WDR on jobs described the findings in economic literature as follows:

"Critics of strong EPL and minimum wages hold that they tend to reduce employment, hinder productivity growth, and can lead to divisions in society between those who benefit from the regulations and those who do not.... New data and more rigorous methodologies have spurred a wave of empirical studies over the past two decades on the effects of labor regulation. These studies examine the influence of EPL and minimum wages on employment, wages, the distribution of wages, and to a lesser extent, productivity.... Based on this wave

¹² Ibid, pp. 34-42

¹³ Ball, Leigh and Loungani, "Okun's Law: Fit at 50?, IMF Working Paper", November 2012.

¹⁴ OECD, *Divided We Stand: Why Inequality Keeps Rising*, 2011, p. 117 & p. 152

of new research, the overall impact of EPL and minimum wages is smaller than the intensity of the debate would suggest. Most estimates of the impacts on employment levels tend to be insignificant or modest.¹⁵

The World Bank's review of economic research literature in the WDR 2013 confirms that fixating on labour market regulations and institutions as being inherently anti-growth and anti-employment is not based on evidence. IMF leaders have stated in the recent past that serious action to attack the jobs deficit requires abandoning unhelpful preconceptions about labour market regulations:

"The crisis taught us that well-designed labor market policies can save jobs.... We must get past the binary and unhelpful contrast between 'flexibility' and 'rigidity' in labor markets and ask instead if policies are effective in creating and sustaining jobs."¹⁶

An *IMF Factsheet* further reminds the public that labour market policies "are not a core area of IMF expertise".¹⁷ This acknowledgement would seem to justify the IMF being particularly cautious about putting forward policy recommendations in this area and instead deferring to national processes of social dialogue between government, trade unions and employers, supported by the international agency which *does* have expertise in the area, the ILO. Unfortunately this is not the manner in which the IMF has proceeded in several of its loan programmes and its policy advice in European countries, as all but one of the following examples demonstrate.

IMF and labour market reforms in Greece

In May 2010, the IMF and European Union institutions, namely the European Commission and the European Central Bank, agreed to extend to Greece a joint loan of \in 110 billion, of which \in 30 billion would be provided by the Fund. The loan contained several conditions which evolved over the first two years of application when several fiscal targets were not met, in part because Greece's economic decline was much sharper than the IMF and EU had forecast. This loan was superseded by a second bailout for a combined loan of \in 130 billion in March 2012, of which \in 28 billion would come from the IMF. The renegotiated loan agreement included an annexed *Memorandum of Understanding on Specific Economic Policy Conditionality* that contained several conditions which were either new or carried over for the first loan:

"The Government publishes and updates on a quarterly basis its medium-term staffing plans per department, for the period up to 2015, in line with the rule of 1

¹⁵ World Bank, *World Development Report 2013: Jobs*, Washington, 2012, p. 261

¹⁶ "The Global Jobs Crisis – Sustaining the Recovery through Employment and Equitable Growth", Speech by IMF Managing Director delivered in Washington, 13 April 2011

¹⁷ "The IMF's Advice on Labor Market Issues", IMF Factsheet, September 2012

recruitment for 5 exits. The recruitment/exit rule applies to the general government as a whole. The staffing plans should be consistent with the target of reducing public employment by 150 thousand in end-2010-end-2015."¹⁸

The 150,000 reduction in the number of government workers represented 22 per cent of the public-sector workforce. It had been introduced as a loan condition during the first IMF loan to Greece covering the period from May 2010 to March 2012, as had requirements to privatize several publicly-owned entities. A December 2011 loan review document noted that it would reduce the proportion of public employment in Greece well below the average in OECD countries:

"By 2015, these reforms would bring general government employment to 12 percent of the labor force, 3 percent below the OECD average (2008), and given the planned wage reforms, would reduce the public wage bill to about 9 percent of GDP, matching some of the lowest spending OECD countries (e.g. Czech Republic and Slovakia)."¹⁹

The same IMF loan review document assessed labour market reform measures that had been taken to reduce wage costs in the private sector and judged their impact to have been insufficient:

"Labor market reforms to date have not managed to deliver enough wage flexibility to prevent pressure on employment. The problem appears to be rooted in inadequate tools to allow wages to adjust in small enterprises ... Hence, it was agreed that further measures would be needed to promote wage flexibility and foster employment ... These measures (adoption of which represented a prior action for the review) could allow wages to fall below existing sectoral floors..."20

The March 2012 IMF-EU loan agreement went further to reduce wages in Greece, including for those working at the lowest wages:

"This [government] strategy should aim at reducing nominal unit labour costs in the business economy by 15 percent in 2012-14 Prior to the disbursement [of the first loan payment], the following measures are adopted:

The minimum wages established by the national general collective agreement (NGCA) will be reduced by 22 percent compared to the level of 1 January 2012; for youth (for ages below 25), the wages established by the national collective agreement will be reduced by 32 percent without restrictive conditions.

¹⁸ IMF. Greece: Request for Extended Arrangement Under the Extended Fund Facility, March 2012, p. 160 ¹⁹ IMF, Greece: Fifth Review Under the Stand-By Arrangement, Rephasing and Request for Waivers of *Nonobservance of Performance Criteria,* December 2011, p. 16²⁰ Ibid, p. 24-25

- Clauses in the law and in collective agreements which provide for automatic wage increases, including those based on seniority, are suspended."²¹

The latest Greek lending agreement also included an additional reduction of 12 per cent in payments for retirees receiving pensions above €1300 per month. Supplementary pensions were to be reduced by as much as 20 per cent. In the first loan agreement, pension benefits had already been reduced for all but the lowest levels through the elimination of so-called bonuses that amounted to an average reduction in pensions of 11 per cent. Access to unemployment benefits was also made more restrictive during the first lending programme by the introduction of means-testing.

Additionally, the 2010 Greek loan agreement introduced an expansion of the use of fixed-term contracts in order to increase labour market flexibility:

"New legislative amendments will permit individuals to work longer hours for a longer period, while reducing the use of overtime pay, and will lower the severance pay associated with fixed-term contracts as well as limit the times these types of contracts can be renewed. It will also provide for an introduction of term contracts for youth to gain work experience at sub-minimum wages."²²

During the two years of application of the IMF's lending programme in Greece, unemployment doubled, from 10 per cent in the first quarter of 2010 to 21 per cent in the first quarter of 2012. The austerity measures aimed at reducing the level of public-sector indebtedness contributed to this increase, as did the deflationary policies aimed at reducing labour costs.

Rather than alleviating the situation of the unemployed as IMF research has suggested should be done, access to unemployment benefits were made more restrictive and pensions were decreased. And rather than encouraging reduced working time so as to allow more workers to maintain employment through work-sharing types of arrangements, labour market flexibility rules introduced at the behest of the IMF-EU loan agreement explicitly aimed to encourage longer working hours for those who still had jobs.

The labour law reforms making it easier for enterprises to be exempted from sector collective bargaining agreements could also hinder any chance of introducing negotiated reduced working-time agreements. In countries where such arrangements are widespread during times of economic downturn, they are almost always implemented through sector-level, regional or national bargaining agreements. The end of

 ²¹ IMF, Greece: Request for Extended Arrangement Under the Extended Fund Facility, March 2012, p. 176
²² IMF, Greece: Fourth Review Under the Stand-By Arrangement and Request for Modification and Waiver

of Applicability of Performance Criteria, July 2011, p. 61

comprehensive sector-level agreements will also contribute to wage dispersion and inequality, as will the reduction of the minimum wage by 22 per cent. The targeted major reduction of wages of those at the lowest income levels seems at odds with the IMF's research demonstrating the stabilizing impacts of reduced income inequality.

Under renewed pressure from the EC-ECB-IMF "troika", the third Memorandum of Understanding on conditions for the renegotiated loan was passed by Greece's parliament in October 2012 with 150 additional austerity and structural reform measures. They included 5 to 15 per cent cuts in pension payments, increase of the retirement age from 65 to 67, wage cuts of up to 40 per cent for employees of state-run enterprises and municipalities, reduction of social welfare and health care spending and increased working hours for public servants.²³

In the review of the most recent loan programme published in January 2013, the IMF acknowledged that Greek workers were bearing a disproportionate share of the costs of adjustment:

"Progress was made in restarting reforms covering product and service market liberalization, the business environment, and the labor market, all areas where significant rigidities linger.... However, the manner of the adjustment leaves much to be desired.... [L]abor has shouldered too much of the burden as lower wages have not resulted in lower prices, because of failure to liberalize closed professions and dismantle barriers to competition. While the economy is now re-balancing apace, this is happening mainly through recessionary channels, rather than through productivity boosting reforms. Meanwhile, the mounting sense of social unfairness is undermining support for the program." ²⁴

The report could also have added that, as well as being forced to accept lower wages and slashed pensions and social programmes, more than a quarter of the Greek workers have been forced out of their jobs as a result of the austerity and adjustment programme. Unemployment reached a record 26.8 per cent in the fourth quarter of 2012 and many of the jobless have lost access to unemployment benefits due to new restrictions.

IMF and labour market reforms in Ireland

The IMF's database shows Ireland's emergency loan with the IMF that began in December 2010 to have been the first lending from the Fund to the country. Ireland requested IMF and EU assistance after its debt/GDP ratio guadrupled following the government's decision in late 2008 to take over all private bank liabilities. The banking

²³ http://www.keeptalkinggreece.com/2012/11/05/third-austerity-package-brought-to-greek-parliamentmeasures-till-the-end-of-time/ ²⁴ IMF, *Greece: First and Second Reviews Under the Extended Arrangement*, January 2013, p. 15 & 41

sector found itself on the edge of insolvency after a collapse of the real estate bubble that the banks had done much to create. The EU institutions agreed to extend a loan of €45 billion and the IMF €22.5 billion.

Part of the strategy to bring down public debt involved the selling-off of assets owned by the failed banks that the government took over; assets sales totalled \in 15 billion in 2011. "Fiscal consolidation" through substantial reductions in the number of public-sector employees and their wage and non-wage costs, and savings in social programme expenditures would make up most of the efforts to reduce the government's deficit.

In the area of social programme reforms, the IMF's loan review reports commented on the "weak job search conditionality" of unemployment benefits and what it deemed to be overly generous child allowances and benefits for the elderly. The Fund advised "a more targeted use of the state's resources to support ... low-income families", and overall, "a more means-tested" approach to benefits.²⁵ The Fund also supported the government's intention that "sanctions will be used to strengthen incentives for participation" in training schemes for the unemployed.²⁶

Another important element of the IMF's lending programme for Ireland concerned changes to sector-level collective bargaining agreements. A Fund loan review document described the changes made at the EU's and IMF's behest:

"The authorities have published draft legislation to reform Employment Regulation Orders (EROs) and Registered Employment Agreements (REAs), which together had set minimum wages and conditions in a number of sectors, including those most affected by the crisis such as construction. Streamlining the employment conditions and the number of wages set under EROs, ensuring that wage setting under EROs and REAs takes economic conditions and competitiveness into account, and increasing flexibility to vary from ERO and REA terms under adverse conditions should help facilitate job creation and adjustment across sectors."27

As in other countries, wage "flexibility" was supported by the IMF as a supposed means to facilitate hiring, although no explanation was provided about how much increased hiring could take place in the context of a shrinking economy.

Fifteen months after the loan programme in Ireland began, the IMF declared it to be a success because the government had achieved the conditions set by the Fund and EU to bring the fiscal deficit down to 10 per cent of GDP in spite of the huge debts it took over from the collapsed private banks. However after declining in 2010, GDP was

²⁵ IMF, Ireland: Fifth Review Under the Extended Arrangement, March 2012, p. 20

²⁶ Ibid, p. 21 ²⁷ Ibid, p. 21

stagnant in 2011 and the unemployment rate almost reached 15 per cent in the first quarter of 2012 and remained at that level throughout the year.

The reductions in child allowances and benefits for the elderly that the IMF supported will likely increase income inequality as well as hinder the possibility of a demand-led recovery. The increased flexibility of wage-setting mechanisms, leading to greater variations in wage levels, will also add to this development.

IMF and labour market reforms in Portugal

Portugal's negotiations with the IMF for a crisis borrowing package were concluded in May 2011. The total loan amount was for €78 billion, one-third of which (€26 billion) came from the IMF. It would be the first IMF loan for Portugal in almost three decades. IMF loan documents explained the objectives of the conditions attached to the loan in the following terms:

"In the absence of exchange rate policy, the program seeks an internal devaluation through front-loaded reforms to increase labor market flexibility, foster competition to exert downward pressure on non-tradable relative prices, and lower social security contributions to increase profitability in the tradable sector.... Over the medium-term, labor market reforms to lower unit labor costs and moderate private sector wage adjustments, as well as measures to increase competition in domestic markets, are expected to promote price competitiveness."²⁸

A main justification used by the IMF for demanding rapid and drastic action to increase labour market flexibility was that the country's "Strictness of Employment Protection Legislation" indicator exceeded those of all but two other European countries, one of which was Greece, according to a figure presented in the loan request report prepared by the Fund.²⁹ This indicator, which the Fund claimed was based on IMF, OECD and Eurostat data and "IMF staff calculations", showed Portugal's employment protection legislation to be more rigid than that of Germany, which in turn had more rigid EPL than Spain.

However, in an IMF report for Spain published only one month later, another "Strictness of Employment Protection" indicator showed Spain to have more rigid EPL than any other country with which it is compared, including Germany, Greece and Portugal! This version of the EPL indicator was purportedly based on information from the OECD; Bloomberg, the Bank of Spain, the ECB and "IMF staff estimates". ³⁰

²⁸ IMF, Portugal: Request for a Three-Year Arrangement Under the Extended Fund Facility, June 2011, p. 9

²⁹ Ibid, p. 5

³⁰ IMF, Spain – Staff Report for the 2011 Article IV Consultation, July 2011, p. 31

It would appear that IMF staff engaged in preparing these country reports, who generally are not deemed to have a great deal of expertise in labour issues, took considerable liberties in coming up with estimates of labour market rigidity. The significant inconsistencies from one report to another produced almost simultaneously give the impression that their measures of employment protection legislation were more agendadriven than fact-based.

Several conditions in the Portuguese lending agreement concerned income security and labour market regulations, including reducing the duration of unemployment benefits and the amounts of severance payments:

"Policies under the program will revise the overly generous unemployment insurance system to change incentives and increase employment ... Measures to be implemented over the next year will also reduce high severance payments, aligning them across fixed-term and open-ended contracts, and revise the overly restrictive interpretations of fair dismissal clauses in the labor code ..."³¹

The IMF loan documents have not attempted to dissimulate that part of the objective of the various measures was to shift the cost of adjustment during the crisis from enterprises to workers:

"A potentially important policy move will be a plan to adopt a fiscally neutral reduction in labor costs, offset primarily by higher consumption taxes and expenditure cuts... lower labor taxes increase the competitiveness of domestic production as firms pass on the decrease in labor costs to final producer prices, while higher consumption taxes reduce consumption. In addition the proposed reduction in labor costs is job creating."³²

The IMF programme with Portugal included limits on minimum wage increases and restrictions on negotiating collective agreements having a sector-level application, as was the case in most of the recent IMF lending agreements in Europe. Such limitations are likely to increase wage dispersion and inequality within Portugal:

"Over the program period, any increase in the minimum wage will take place only if justified by economic conditions and agreed in the context of regular program reviews. In addition, commitments under the program will ensure clear criteria for the extension of collective wage bargaining agreements. These criteria will take into account the competitive position of firms."³³

³¹ IMF, *Portugal: Request for a Three-Year Arrangement Under the Extended Fund Facility*, June 2011, p. 17-18

³² Ibid, p.18

³³ Ibid, p. 18

The IMF programme explicitly sought not only to decentralize collective bargaining from the sector to the enterprise level, but also to weaken the role of trade unions. A June 2011 loan request report published by the IMF included a specific commitment by the Portuguese government: "[to] promote the inclusion in sectoral collective agreements of conditions under which work councils can conclude firm-level agreements without the delegation of unions."³⁴

In lending agreement reports for Portugal published in 2011 and 2012, the IMF insisted that the labour code should be modified to restrict the sector-wide extension of collective agreements. The revision of the labour law limiting the extension of collective agreements was duly approved by the Council of Ministers on 10 October 2012. In spite of the measures already taken, in January 2013 the Fund pushed for further labour market deregulation, including a reduction of severance payments:

"The mission has reached understandings on steps to further enhance labor market flexibility. Significant measures have already been adopted over the past year to improve the functioning of the labor market, including the recent reform of wage bargaining to ensure wages better reflect heterogeneous firm-level conditions. The government agreed to further lower severance payments to 12 days per year of service... Labor market reforms would help reduce structural unemployment."³⁵

However the claimed ultimate objective of the programme – job creation – did not materialize. Even as Portugal applied its austerity measures, including reductions in unemployment benefits and inequality-inducing labour market flexibility reforms, unemployment continued to increase, reaching 15.8 per cent during the third quarter of 2012; the IMF forecast further increases in 2013.³⁶ As in all of the other programme countries in Europe, the economic shrinkage exceeded IMF and EU expectations, although any serious analysis would show that the strategy of "growth through austerity" was only an illusion. By January 2013 the IMF confirmed that GDP had fallen by 1.6 per cent in 2011 and predicted that it would decline by 3 per cent in 2012 and a further 1 per cent in 2013.³⁷

IMF and labour market reforms in Romania

Romania has had several IMF borrowing agreements since the 1980s, although when it concluded an agreement for a loan in May 2009 in the midst of the financial and economic crisis the country had functioned without a Fund loan during the preceding three years. The €13 billion loan agreed by the IMF was supplemented by a €5 billion

³⁴ Ibid, p. 99

³⁵ Ibid, Portugal - Article IV Consultation and Sixth Review Under the Extended Arrangement, January 2013, p. 13.8-20

p. 13 & 20 ³⁶ Ibid, p. 23

³⁷ Ibid, p. 33.

loan from the EU and €1 billion from the World Bank. In March 2011 the IMF loan was replaced by a "precautionary stand-by arrangement" for €3.5 billion.

The loan programmes included substantial austerity measures which were overwhelmingly carried out through expenditure reductions, the most important of which were decisions taken in 2010 to reduce public sector wages by 25 per cent and pensions and social assistance by 15 per cent. (The pension reductions were subsequently declared illegal by Romania's constitutional court.)

In June 2011 the IMF's loan review report described in positive terms the legislative actions taken by the Romanian government to enhance labour market flexibility and to "streamline" social protection:

"The authorities have undertaken important reforms in labor legislation and social protection. The new Labor Code, enacted April 30, aims to improve labor market flexibility by promoting fixed-term and temporary employment, extending probation periods, and increasing the flexibility of working hours. The controversial Social Dialogue Code was recently promulgated ... It aims to make the wage-setting process more flexible ... Key elements include raising the representativity thresholds for both trade unions and employers' associations, abolishing the collective bargaining at national level, and elimination of the automatic ergo-omnes extension at the sectoral level. The authorities are continuing making efforts to streamline social assistance while protecting the vulnerable through means-testing of benefits.... Social inspection has yielded significant results, as the number of beneficiaries of heating allowances has declined by half in 2011."³⁸

It appears that the IMF strongly pushed the Romanian government to adopt the labour market flexibility reforms it enacted in 2011. A year before publishing the loan review document from which the above quote is taken, the Fund issued a report that encouraged the government to initiate reforms to increase flexibility of the labour market:

"Improving Romania's business climate would boost Romania's growth potential. Romania lags behind other EU member States in terms of quality of business environment according to indicators on ... ease of doing business (World Bank) or competitiveness (World Economic Forum).... Romania slid down by ten positions on the World Bank's ease of doing business ranking in the past year. In particular, Romania has room for improvement in tax simplification, contract enforcement and hiring.... Romania's labor market is rigid compared to other countries in the region.... Labor reforms should include helping low-skilled workers enter the job market and promoting senior labor. The authorities ...

³⁸ IMF, Romania: First Review under the Stand-By Arrangement and Request for Modification of Performance Criteria—Staff Report, June 2011, p. 12

envisage modifying the labor code in order to increase working time flexibility and to reduce hiring and firing costs."³⁹

The IMF's invocation of the *Doing Business* labour market rigidity indicators to persuade the Romanian government to undertake deregulatory labour law reforms is particularly troublesome and demonstrates a lack of serious investigation by the IMF into the various labour market rigidity indicators that it uses. In October 2009, nine months before the IMF issued this report for Romania, the World Bank had suspended the production of this indicator, called the *Employing Workers Indicator* (EWI), and ordered its staff to refrain from any recommendation based on the previously published EWI "in Country Assistance Strategies / Country Partnership Strategies, Economic and Sector Work, Doing Business Reform memoranda, policy notes and other strategy or analytical work".⁴⁰

Moreover, the Fund's assertion in its July 2010 report that Romania would improve its growth potential by improving its *Doing Business* ranking was based on no factual evidence. In 2008, the World Bank's Independent Evaluation Group (IEG) published a report which stated that it had "found no statistically significant relations between the ... DB indicators and growth rates ... no significant association between ... *employing workers* [indicators] and employment ... [and] no significant relationship between reforms as measured by changes in the DB indicators and aggregate investment and unemployment rates".⁴¹

As with some other country-level recommendations regarding labour market reforms, IMF staff's limited expertise in this area was on full display in the case of Romania. Fund staff appear to have been unaware that the World Bank had stopped publishing and had disavowed a labour market flexibility indicator that the IMF used to justify a major deregulatory reform. They also made assertions about the relations between these indicators and economic outcomes that the Bank's IEG had declared, in a published report, to be unfounded.

By facilitating the use of temporary employment contracts with reduced rights and benefits for employees, the labour law changes supported by the Fund may well contribute to inequality through greater dispersion in wages and differences in benefits. Furthermore, the abolition of national collective bargaining and limits on sector-level bargaining have not translated into increased collective bargaining on the firm level. On the contrary, the labour law reform enacted in of April 2011 and supported by the IMF resulted in a drastic decline of the number of enterprise-level agreement because of obstacles the new rules created for collective bargaining at any level. Preliminary

³⁹ IMF, Romania – Staff Report for the 2010 Article IV Consultation, Fourth Review Under the Stand-By Arrangement, and Requests for Modification and Waiver of Nonobservance of Performance Criteria, July 2010, p. 26-27

⁴⁰ World Bank, Guidance Note for World Bank Group Staff on the Use of the Doing Business Employing Workers Indicator for Policy Advice, October 2009, p. 1

⁴¹ World Bank - Independent Evaluation Group, *Doing Business: An Independent Evaluation*, 2008, p. 6

figures provided to trade unions by the labour ministry revealed that the number of firmlevel collective bargaining agreements at mid-2012 had fallen by 50 per cent from the number prior to April 2011.

In mid-2012 a new Romanian government, with the support of all trade union confederations and most employers' associations, took action to try to correct the worst flaws of the 2011 law that led to a collapse of collective bargaining. The ILO had earlier deemed the law to be in violation of one its fundamental workers' rights conventions, Convention 98 on the Right to Organize and Collective Bargaining. But instead of supporting Romania's effort to ensure that its labour legislation comply with an international convention it had ratified, the IMF jointly with the European Commission urged the government to leave in place the parts of the law that were non-compliant. In October 2012 the two institutions submitted comments to the government urging that it not proceed with the proposed modification.

Among the recommendations the Fund and the EC made to the Romanian government were that it should ensure that national collective agreements "do not contain elements" related to wages", limit the number of workers representatives who are protected from anti-union discrimination or retaliatory firing, and limit the ability of trade unions to undertake lawful strikes.⁴² All of these recommendations constituted advice to maintain labour law provisions that were in violation of ILO Convention 98.43

In addition, the collapse of collective bargaining in Romania will make it even more difficult to introduce the kinds of agreements, such as broadly applied reduced workingtime arrangements, which have successfully contributed to mitigating the impact of the crisis on the labour force in some other European countries

IMF and labour market reforms in Bulgaria

Bulgaria's last stand-by arrangement with the IMF ended in March 2007, but until then it had almost uninterrupted lending agreements with the Fund beginning in the early 1990s, such that the IMF had a strong influence on policy reforms in the country. Labour market regulations and social programmes were among the themes frequently raised by the IMF in its policy advice.

In an analysis published in 2001, the IMF observed that labour markets were liberalized early in the transition period: "There is relatively little in the way of constraints on the

⁴² "Romania, Draft Emergency Ordinance to Amend Law 62/2011 on Social Dialogue: Joint Comments of European Commission and IMF Staff", October 2012

⁽available at: http://www.ituc-csi.org/IMG/pdf/romania.pdf) ⁴³ ILO, "Observation (CEACR) - adopted 2011, published 101st ILC session (2012) Right to Organise and Collective Bargaining Convention, 1949 (No. 98) - Romania"

⁽http://www.ilo.org/dyn/normlex/en/f?p=1000:13100:0::NO:13100:P13100_COMMENT_ID:2698945)

ability of enterprises to hire and dismiss employees, unions have relatively minor roles, minimum wages are fairly low, and unemployment insurance is not overly generous."44

However this did not prevent the IMF, throughout the decade of the 2000s, from encouraging the Bulgarian government to engage in further labour market deregulation measures, such as easing restrictions on dismissals, increasing working time flexibility and eliminating seniority bonuses.⁴⁵ The government carried out several of these reforms.

Whatever benefits the labour market flexibility measures brought to the Bulgarian economy, they certainly did not accrue to workers. By the end of the decade, unemployment exceeded 11 per cent and Bulgaria had the lowest average wage and lowest minimum wage among all of the 27 EU member countries, the same position it was in at the beginning of the decade. During most of the 2000s until 2007, productivity growth exceeded wage increases, thus leading to a decline in labour's share of national income.

While some catch-up in wages took place in the last years of the decade, wage growth once again began to moderate with the recent increase of unemployment. The IMF's executive director for Bulgaria viewed this development in a positive light since "this has boosted further the competitiveness of the Bulgarian economy".⁴⁶ However it will also increase income inequality.

Bulgaria had also undergone a major reform of its old-age pension system during the 2000s, with the introduction of a "second-pillar" private pension programme, following the World Bank's preferred model at that time of mandatory partially privatized pensions. The diversion of part of pension contributions into the privatized pillar along with the challenges of an ageing workforce (exacerbated by the departure of many young workers to higher-wage countries elsewhere in Europe) created significant strains on the public pension system. These were made even worse when the 2008 financial crisis decimated the value of the mandatory privatized funds.⁴⁷

Negotiations between the government, employers and trade unions sought to address the financial challenges faced by the Bulgarian pension system and a tripartite accord for reforms was adopted in December 2010. The reform involved raising the contribution rate, increasing service periods and gradually increasing the retirement age. The objective was to eliminate the pension deficit and preserve the system's medium-term financial stability while ensuring adequate benefits.

⁴⁴ IMF. Labour market in hard pegged EU accession countries, 2001, p. 7 (quoted in ILO, Promoting Decent Work and Social Justice in Bulgaria: An ILO Contribution to the Economic and Social Policy Debate, 2012,

p. 27) ⁴⁵ ILO, Promoting Decent Work and Social Justice in Bulgaria: An ILO Contribution to the Economic and Social Policy Debate, 2012, p. 27-28 ⁴⁶ IMF, Bulgaria: 2011 Article IV Consultation – Staff Report, July 2011, Annex p. 1

⁴⁷ ILO, Promoting Decent Work and Social Justice in Bulgaria: An ILO Contribution to the Economic and Social Policy Debate, 2012, p. 39-42

The IMF acknowledged the importance both of the reforms agreed by the tripartite partners and the freezing of pension benefits until the end of 2012. Nevertheless in July 2011, several months after the government-employer-union agreement, the Fund encouraged Bulgaria to carry out further reforms in contravention of the tripartite accord:

"The 2010 pension reform yielded 0.6 percent of GDP in savings per year, but ... further efforts are needed to make a dent in the sizeable deficit projected post-2016, including further increases in the retirement age and service period ..."⁴⁸

The government followed the Fund's advice and accelerated increases of the retirement age and other changes, thus provoking major protest actions by workers. The IMF, however, praised the violation of the tripartite agreement on pension reform:

"We welcome the proposals to move more quickly with pension reforms. The gradual increase in the retirement age starting from January 2012 and the extended service requirements will help fund an increase in the minimum pension. In the medium-term, these reforms will yield substantial savings."⁴⁹

The IMF's support for labour market deregulation measures during the 2000s, in a context of an already relatively flexible labour market, as well as the recent further restrictions on pension benefits decreed by the government in violation of a tripartite agreement, will do nothing to improve the lot of working people in the lowest-wage member state of the EU. These actions may also contribute to an accelerated departure of workers to higher-wage EU countries.

IMF and labour market reforms in Spain

As was the case in Ireland, Spain's current economic difficulties were caused by a massive real estate bubble followed by an equally massive bust of the private financial sector. However, a considerable part of the IMF's agenda for reform in Spain has focused on the labour market. Since Spain currently does not have a borrowing agreement with the Fund, its advice to the country has been proffered in annual Article IV Consultation reports, which the IMF prepares for all member countries.

The IMF's recommendations for labour market flexibility reforms in Spain have been insistent and detailed, as shown in the Fund's last two country reports. A first excerpt from the July 2011 Article IV report describes the reforms carried out in 2010 and 2011. The IMF report implied without providing any specific citation that the social partners and the ILO endorsed these measures and supported even deeper reforms, something that

⁴⁸ IMF, Bulgaria: 2011 Article IV Consultation – Staff Report, July 2011, p. 14-15

⁴⁹ IMF Press Release, *Conclusions of the 2011 Regular IMF Staff Visit to Bulgaria*, 9 December 2011

is certainly not borne out by the Spanish trade union confederations' multiple actions against deregulatory reforms, including two general strikes held in 2012:

"Labor: Bolder Reform Needed ...

The 2010 reform increased hiring incentives by easing dismissal costs and criteria, and by granting firms greater flexibility to opt out of collective agreements. In June 2011, collective bargaining was further reformed toward greater firm-level flexibility through: (1) establishing the prevalence of firm-level agreements, especially over provincial ones; (2) reducing the possibility of indefinite extension of previous agreements when social partners cannot agree on a new agreement; (3) further easing opt-outs of collective agreements; and (4) giving firms more internal flexibility. Most interlocutors including social partners, the International Labor Organization (ILO), and academics broadly agreed the labor market reforms to date were in the right direction. Nevertheless, as many of the interlocutors also underscored, the reforms were incomplete and remain a work in progress."⁵⁰

The IMF justified the need for "bold" labour market reform by referring to comparative "Strictness of Employment Protection" indicators that showed Spain to have more rigid labour rules than any other country with which it was compared, including Germany, Greece and Portugal.⁵¹ But, as pointed out in the preceding section on Portugal, these data were contradicted by other employment protection legislation indicators that the IMF published a month earlier which showed that the latter three countries and several others had more rigid EPL than Spain.⁵²

After making its diagnosis on the basis of made-to-measure international comparisons, seemingly designed to fit the conclusions that the authors aimed to draw, the IMF's Article IV report called on Spain to engage in much deeper labour market reforms. These reforms were summarized in the following fashion:

"The labor market is being reformed in the right direction. But the results to date do not provide sufficient confidence that the reforms will quickly deliver an improvement in labor market dynamics that is as strong as the severity of the problem requires.... This calls for deepening and broadening the reforms so far. In particular: collective bargaining needs to be effectively decentralized to the firm level; social partners should move away from inflation indexation; and severance payments should be further lowered to at least EU average levels."⁵³

The government responded to these appeals with another major reform of labour market regulations and institutions in February 2012. Main changes include the decentralization

⁵⁰ IMF, Spain – Staff Report for the 2011 Article IV Consultation, July 2011, p. 25

⁵¹ Ibid, p. 31

⁵² IMF, Portugal: Request for a Three-Year Arrangement Under the Extended Fund Facility, June 2011, p. 5

⁵³ IMF, Spain – Staff Report for the 2011 Article IV Consultation, July 2011, p. 30

of collective bargaining by giving highest priority to firm-level collective agreements, the reduction of severance payments and the extension of trial periods for permanent contracts to one year.⁵⁴

The IMF's call to achieve lower real wages (since wages would no longer keep up with the cost of living) was similar to those made in several other European countries, as was the recommendation to do away with all types of national, regional or sector-level collective bargaining. As in other European countries whose depressed domestic markets are prolonging recessions, the further compression of workers' real wages is something that the Spanish economy, with its 26.0 per cent unemployment rate in the fourth quarter of 2012 – rivalling Greece for the highest in Europe – can ill afford. The dismantling of sector-level bargaining will hinder the possibility of coordinated adoption of some of the measures that the IMF has itself put forward as means to mitigate the impact of high joblessness, such as reduced working-time agreements.

IMF and labour market reforms in Italy

Even prior to the 2008-2009 global recession, the Italian economy experienced slower growth than the EU average, and with the onset of the crisis the level of public indebtedness led to increasing costs for issuing public bonds in the private market. The IMF supported sharp austerity measures in order to bring down the deficit. As in other European countries, these measures were a contributing factor to Italy's double-dip recession: the recession years of 2008 and 2009 were followed by slow but positive GDP growth in 2010 and 2011, but the economy entered into a renewed decline in 2012 that the IMF predicts will continue into 2013.

IMF Article IV reports for Italy since 2008 have attempted to explain Italy's slow growth both before and during the crisis and, judging from the amount of space devoted to the topic, it is obvious that the IMF considers labour market institutions to be a major culprit. "Labor market rigidities" were analysed in the main text and in a special annex on "Reforming Italy's Labor Market" of the Fund's 2008 Article IV report for Italy; each subsequent annual Article IV report came back to the theme. Interestingly, the 2008 report for Italy acknowledged that "permanent EPL appear comparatively low according to the OECD indicators" and that "on some dimensions Italy actually appears less regulated than the EU average".⁵⁵ Despite this acknowledgement, the IMF report considered that "employment protection is too high overall [and] it is specifically its asymmetry that causes additional distortions".⁵⁶

⁵⁴ Ministerio de la Presidencia, España, *Boletín Oficial del Estado, Decreto-Ley núm. 3/2012 de medidas urgentes para la reforma del mercado laboral,* 11 February 2012, p. 12483-12546.

⁵⁵ IMF, Italy: 2008 Article IV Consultation—Staff Report, February 2009, p. 62-63

⁵⁶ Ibid, p. 65

Some deregulatory measures were taken by the Italian government and a subsequent IMF Article report recognized the negative impact of the resulting "improved" labour market flexibility:

"While the deregulation of fixed-and part-term contracts in recent years has improved labor market flexibility, it has also resulted in more 'atypical' employment, contributed to stagnant labor productivity, and exposed workers to increased employment risk without commensurate improvements in the social safety net.... The contrasting movements of labor and total factor productivity may be partly an (unwanted) effect of sweeping labor market reforms."⁵⁷

The 2011 Article IV report went further and stated that labour market liberalization "may have undermined investment in human capital and innovation".⁵⁸ But rather than question the wisdom of the deregulatory measures taken, IMF reports called for a "second generation of reform" of the labour market that would address the aforementioned "asymmetry" in labour market regulations and institutions. A key item in this agenda would be decentralization of collective bargaining:

"Only a comprehensive reform package can deliver growth.... Promoting decentralized wage bargaining would allow wages to be better aligned with productivity, providing firms with stronger incentives to invest. Harmonizing labor contracts and employment legislation between permanent and temporary employment would reduce labor market dualism and raise employment."⁵⁹

Since the previous deregulatory reforms had led to decreased labour productivity among those in "atypical" employment relations, i.e. precarious workers, one can presume that the proposal to align wages more closely to productivity would increase wage disparity and income inequality. This and other IMF reports for Italy spoke favourably of formulas whereby firm-level negotiations take priority and participation in national negotiations would become optional.

The IMF's Article IV report for Italy for 2012 repeated these suggestions, but for the first time after several years of pushing for extensive deregulatory labour market reforms, the report revealed the very modest impact the Fund expected they would have. A table in the report showed that in the "long run", a comprehensive package of labour and product market reforms would increase Italy's GDP by 10.5 per cent. Only one-sixth of that increase (1.8 per cent) was expected to come from labour market reforms, a fact that accompanying text stated could be "explained in part by a relatively smaller gap with best practice cases".⁶⁰

⁵⁷ IMF, Italy: 2010 Article IV Consultation—Staff Report, May 2010, p. 27

⁵⁸ IMF, Italy—Staff Report for the 2011 Article IV Consultation, July 2011, p. 27

⁵⁹ Ibid, p.31

⁶⁰ IMF, Italy: 2012 Article IV Consultation, July 2012, p. 16

Similar to the IMF paper "Fostering Growth Now" quoted earlier, there is an evident lack of balance between the high level of priority and weight given to deregulatory labour market reforms and the modest impact IMF staff expect the reforms to have relative to other policy initiatives. And, it should be added, the Fund's modest expectations as to the positive economic impact of the labour reforms tend to be on the high end in comparison to academic literature or more in-depth studies carried out by the other institutions, as noted in an earlier section.

Additionally distressing is that the IMF's reports appear to pay no attention to the negative impacts of labour market deregulation until after they have happened. In the case of Italy, the IMF's reports did not foresee the negative impact of deregulation on productivity until the reforms had been implemented. Although IMF research papers allude to possible economic contraction due to decreased buying power when labour regulations are weakened, no mention of that effect is made in the reports for Italy. As noted above, the country fell into the second half of a double-dip recession in 2012.

Likewise, while IMF reports strongly support a substantial weakening of national collective bargaining arrangements in favour of firm-level negotiations, no mention is made of the successful use of national arrangements in other countries to mitigate the impact of the crisis on workers and on the economy as a whole. If Italy were to continue weakening these collective bargaining structures, it may become even more difficult to arrive at national consensus on the steps to take in order to put Italy back on a sustainable employment-creating growth path. Some successful examples of use of centralized collective bargaining arrangements are presented in the final two country cases.

IMF and labour market reforms in Germany

Germany's labour market performance since the onset of the economic crisis in 2008 has been distinctly different from the other EU countries considered in this paper. Several policy measures adopted by German employers and trade unions with government support, notably the well-known *Kurzarbeit* (reduced working time) programme, were an important factor explaining a fall of unemployment rates during the crisis rather than a dramatic increase as took place in the preceding countries. Also important is the fact that Germany over the past decade has become a high current-account surplus economy within the EU and internationally, due in no small part to a policy of wage moderation that the IMF strongly encouraged throughout the 2000s as a means of making the German economy more "competitive".

While no doubt effective in enhancing Germany's competitiveness vis-à-vis its EU partners, the successfully applied wage restraint policies translated into growing current-account deficits in several other EU countries, and the resulting imbalance has played an important role in the euro-area crisis. IMF staff recommendations for Germany

published throughout the 2000s seemed oblivious to the economic destabilization which could occur, despite the fact that their reports reveal that as early as in 2000 the German government had warned the Fund of the euro-zone-wide consequences of sustained wage moderation practised in Germany:

[IMF] staff pointed to the risk of significant pressures – especially from higherskilled workers – to realize wage increases consistent with their productivity growth. The authorities were less concerned about such domestic pressures but were wary 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.⁶¹

Instead of paying heed to these warnings, the IMF constantly encouraged the German government to adopt measures to enhance labour market flexibility and wage restraint, the point of praising trade unions in 2001 for moderating their wage demands during sector-level collective bargaining:

Continued wage moderation will be essential to aid recovery and get unemployment back on a declining track. Trade unions deserve credit for putting jobs before wages increases in recent years, and until the latest growth slowdown, this was helping to lower unemployment. But progress could be undone, and the prospects for economic recovery unsettled, if in the 2002 wage round unions were to seek compensation.⁶²

Despite the apparently positive impact on German exports, to which unions and employers had contributed through their centrally coordinated collective bargaining, the IMF called for further flexibility and the dismantling of centrally coordinated collective bargaining, such is in a 2004 Article IV Consultation report:

With sustained wage moderation and efforts underway by social partners to make labor markets more flexible, competitiveness has improved and exports are responding well to increased world demand.... [However] it will also be important to take further steps to make hiring and firing more flexible, and to support the trend toward greater flexibility by reducing remaining central controls on wage bargaining.⁶³

Later Article IV reports acknowledged some negative impacts of wage moderation as practised in Germany, such as a fall of the wage share in national income and a shrinking national tax base:

⁶¹ IMF, Germany: 2000 Article IV Consultation – Staff Report, November 2000, p. 17

⁶² IMF, Germany: 2001 Article IV Consultation—Staff Report, November 2001, p. 32

⁶³ IMF, *Germany: 2004 Article IV Consultation—Staff Report*, November 2004, p. 36&38

The weakness in labor markets and the need for wage moderation, in the context of an increasingly competitive global environment, have contributed to a secular decline in the labor share of national income. With two-thirds of all revenue derived from wage income, there has been a steady erosion of the fiscal revenue base.64

But the Fund did not let up in its continued pressure for measures that would result in further deterioration of workers' income share, arguing against both Germany's adoption of a minimum wage and plans to regulate temporary work agencies, where much of the low-wage employment was concentrated. Despite the fact that Germany was and remains one of a very small number of industrialized countries not to have a minimum wage, the IMF claimed that "minimum wages would be a serious policy error, as these would introduce subfloors in wage setting".⁶⁵ Instead, IMF staff stated their view that "labor market deregulation beyond the Hartz reforms is essential".66

Germany was not the only high current-account surplus economy in the euro area where the IMF recommended sustained efforts to moderate labour costs. In the other major euro-zone economy in this category, the Netherlands, the IMF promoted the following in 2007:

Upward pressure on wages seemed inevitable.... Against this background, staff stressed the importance of wage moderation to take full advantage of the favourable economic environment.⁶⁷

After the 2008-2009 global recession struck, IMF noted the positive impact that policy initiatives in Germany had made in keeping unemployment low:

Automatic stabilizers and significant fiscal stimulus contained the downswing and supported the recovery. And the surprisingly strong German labor market reflected flexibility gains from past labor market reforms, together with the expansion of the short-term subsidies (Kurzarbeit) program.⁶⁸

Given that other industrialized countries with more flexible labour markets than Germany, such as the United States, had far worse unemployment outcomes, it is likely that factors other than deregulation – such as the aforementioned Kurzarbeit programme – were the main factors explaining Germany's positive performance. However the IMF reports failed to mention that coordinated sector-level collective bargaining agreements played a major role in assuring the widespread application of reduced working time.

⁶⁴ IMF, Germany: 2005 Article IV Consultation—Staff Report, January 2006, p. 22

⁶⁵ IMF. *Germany: 2006 Article IV Consultation—Staff Report*, December 2006, p. 14

⁶⁶ Ibid, p. 13

⁶⁷ IMF. Kingdom of the Netherlands—Netherlands: 2007 Article IV Consultation—Staff Report, June 2007, p.

 ⁶⁸ IMF, Germany: 2010 Article IV Consultation—Staff Report; March 2010, p. 3

IMF staff reports finally acknowledged the serious imbalances that had arisen within the euro-zone due in part to differences in unit labour costs and relative prices, something which a previous German government had warned the Fund a decade earlier would come about as a result of a policy of sustained wage moderation in their country. But in 2010 the Fund's response was, as always, more labour market flexibility as the cure for all ills:

"Within the euro area relative prices will have to adjust to prevent continued imbalances and safeguard growth. For Germany, the way forward would be additional labor reforms ..."⁶⁹

In the most recent Article IV report for Germany, issued in July 2012, the IMF stated that the economy would no longer have to rely on exports to drive growth but would benefit from a "natural process of rebalancing". The Fund claimed that the German economy was on the cusp of strong domestic-demand-led growth:

"The underlying strength of the labor market is expected to underpin domestic demand-led growth. In this regard, a pick-up in wages and asset prices should be seen as part of the natural process of private sector-led rebalancing.... Several conditions are now in place in Germany for a domestic demand-led recovery."⁷⁰

Unfortunately, the "underlying strength" of Germany's labour market, after more than a decade of efforts to diminish workers' protection and weaken collective bargaining institutions, was well below the IMF's staff report's optimistic prognoses. In January 2013 the IMF's economics department forecast that Germany's GDP would grow by an anaemic 0.6 per cent in 2013,⁷¹ below the growth rates of 2012, 2011 and 2010, and almost a full percentage point lower than the growth forecast the Fund had made at the time its Article IV report for Germany was issued six months earlier.

IMF and recovery strategy in Iceland

Iceland entered into a severe financial and economic crisis in October 2008 following a collapse of three major banks in the country. Within a month the IMF concluded a lending agreement with Iceland that differed substantially from other loan programmes in the European crisis countries. Instead of pressing for a dismantling of institutions for centralized bargaining, the Fund accepted the government's argument that they could help the country undertake the adjustments needed to rebuild the economy while protecting the interests of the most vulnerable. The Fund also accepted that the government should not turn all private bank liabilities into public liabilities, contrary to the

⁶⁹ Ibid, p. 28

⁷⁰ IMF, *Germany: 2012 Article IV Consultation*, July 2012, p 1&5

⁷¹ IMF, World Economic Outlook Update, January 2013

"socialization" of bank debts that created the public debt crisis in Ireland and some other European states.

The distinctive approach taken in Iceland was expressed in the IMF's first loan programme document in 2008:

It is, therefore, essential that the Government does not take on responsibility for liabilities of the intervened banks other than those relating to guaranteed deposits. More generally, the public sector should not socialize other losses, however painful the impact of the banking crisis will be on those who have lost substantial wealth, domestically and abroad.... Iceland has dealt well with shocks in the past. One important aspect of this is the history of cooperation between the social partners in the labor market, not least when [the] economy is exposed to adverse shocks.72

A year after Iceland's loan agreement was concluded the IMF emphasized further the important role of obtaining support for the agreement from unions and employers in confronting the crisis:

The ... coalition government ... has laid out plans, consistent with the IMFsupported program's objectives, to address Iceland's challenges, and it has sought and received the support of social partners including labor unions ...⁷³

The IMF's 2009 report mentioned in particular the government's "coordination with social partners on wage settlements". The report also described the stability pact agreed with unions and employers, which aimed at attaining fiscal balance through actions split more-or-less evenly between spending cuts and measures "to achieve a fair distribution of the increased tax burden".⁷⁴ Subsequent IMF reports noted that the latter included the introduction of a net wealth tax, new environmental and carbon taxes, and an increase in the tax rate on capital gains. They also reiterated: "It will ... be important that authorities and social partners agree on wage settlements consistent with low inflation and sustained competitiveness."75

Iceland's highly coordinated and centralized collective bargaining practices seemed to have achieved this objective. In fact, in the last loan review report before the lending agreement expired in August 2011 the IMF expressed satisfaction about the results of centralized collective bargaining agreements but also concern that some sectors might be able to opt out of the central wage pacts:

⁷² IMF, Iceland: Request for Stand-By Arrangement—Staff Report, November 2008, p. 24-25

⁷³ IMF, Iceland: Staff Report for First Review under Stand-By Arrangement, October 2009, p. 3 ⁷⁴ Ibid, p. 20 & 74

⁷⁵ IMF, Iceland: Fourth Review under Stand-By Arrangement, January 2011. p. 21

The recent economy-wide wage agreements should help secure stability in the labor market for three years, but ... the wage agreement could break down if "opt out" clauses are triggered, possibly leading to higher wage increases going forward.⁷⁶

The Fund's expressions of praise and support for strong institutions of social dialogue and collective bargaining on the national level in Iceland differed significantly from the positions it took in the eight other European countries examined above, where the Fund strongly encouraged weakening or dismantling of centralized bargaining structures, including through formulas for opting out of national or sector-level agreements. An article published in the *IMF Survey* in November 2011 also highlighted:

"... a decision not to tighten fiscal policy during the first year of the program, which helped protect the country's welfare state ... The result was that inequality in Iceland actually decreased during the [IMF] program ... Iceland set an example by managing to preserve, and even strengthen, its welfare state during the crisis. Recent IMF research has shown that countries tend to grow faster and more consistently when income distribution is more equitable."⁷⁷

The characteristics of Iceland's recovery stand in stark contrast to those of another small European country, Latvia, sometimes presented by the IMF as a success story because economic growth turned positive in 2011-2012 after a loss of a quarter of GDP between 2007 and 2010. The IMF observed that Latvia's fiscal consolidation was carried out overwhelmingly through cuts in social spending, labour markets are flexible and unionization is low.⁷⁸ Unemployment declined to 16 percent in 2012 after hitting a peak of over 20 in 2010 (the decline was partly due to high emigration of job-seekers), but as the IMF noted in its 2012 report: "Latvia's poverty rates remain among the highest in Europe [and] severely materially deprived people accounted for 27.4 percent of the population ... Income inequality deepened and is now one of the highest in the EU."⁷⁹

The very different results from Iceland's response to the crisis – relying, as IMF reports highlighted, on involvement of the social partners and a centralized collective bargaining system – were notable not only for preserving the welfare state and reducing inequality but also in rapidly redressing the employment situation. By the last quarter of 2012 the seasonally-adjusted unemployment rate fell below 6 percent, down from a peak of over 9 per cent two years earlier.

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⁷⁶ IMF, *Iceland: Sixth Review Under the Stand-By Arrangement*, August 2011, p. 9

⁷⁷ *IMF Survey online*, "Iceland's Unorthodox Policies Suggest Alternative Way Out of Crisis", 3 November 2011

⁷⁸ IMF, *Republic of Latvia 2010 Article IV Consultation*, December 2010

⁷⁹ IMF, Republic of Latvia: Fifth Review Under the Stand-By Arrangement, February 2012, p. 5 & 23