QUESTION 8 Protecting workers or protecting jobs?

Policies that protect people are usually hailed as being better than policies that protect jobs. Providing income support prevents large drops in consumption and mitigates the risk of poverty among households affected by unemployment, underemployment, or loss of labor earnings. Relying on transitional income support and, in some cases retraining programs, rather than measures to protect jobs allows for the reallocation of labor, keeping up the process of creative destruction. Resources are thus allocated more efficiently and economic growth is enhanced. Preserving jobs that are no longer economically viable through government transfers and employment protection legislation prolongs an inefficient allocation of resources.

Moreover, job protection also entails a high risk of capture. It runs the danger of becoming permanent rather than temporary, creating enduringly unproductive, subsidized jobs. The development experience is full of examples in which explicit job protection has led to little other than large rents for business owners and workers in the sectors that benefited from it, stifling technological advance, structural change, and growth.

The conventional wisdom, then, argues against the protection of jobs. But in times when many jobs are lost or threatened at once and few are being created, such conventional wisdom needs to be revisited. The productivity of a protected job can still be higher than that of the alternative jobs the displaced worker may find. And the productivity gap may exceed the costs of keeping the job alive. This is likely to be the case when the alternative after displacement is to be jobless for a long period of time. In this case, in addition to the immediate loss in output, prolonged unemployment can depreciate skills and undermine social cohesion.

Importantly, it is the overall productivity of the job that needs to be considered, including its possible spillovers on the productivity of others. When people work together, or when they are connected through broader value chains, the loss of a large number of jobs may have ripple effects on productivity. In areas or activities where jobs have important productivity spillovers, the aggregate loss of output is then more than the sum of the losses in individual earnings. Massive job losses can then lead to ghost towns and depressed regions, and this prospect suggests that the conventional wisdom may not always be right.

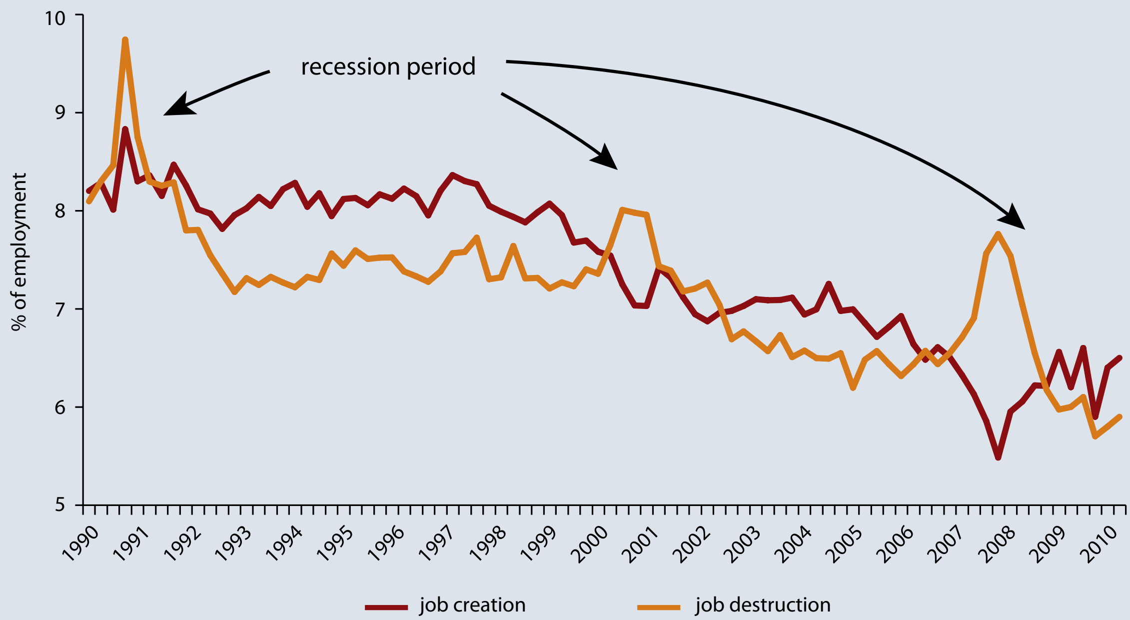
Turnover versus decoupling

Every day, jobs are created and destroyed. Workers are hired and dismissed, or they quit their jobs and start their own businesses; meanwhile some firms close and others are born. In industrial countries, this process of creative destruction affects around 15 percent of all jobs every year.[86] In normal times, the probability of job loss for an individual is largely independent of the probability of job loss for another. And the probability of landing another job is also independent of what happens to other workers. The employment shock is then what economists call "idiosyncratic."

But there are exceptional times, when employment shocks are systemic. Then, a sustained decoupling of the normal process of job creation and job destruction occurs: jobs are lost in large numbers but not created at the same pace. This is what occurs in times of severe economic crises, when a decline in economic activity affects a broad swath of firms and industries. Job destruction accelerates, often sharply, and job creation levels off or even decreases (figure 8.7). This decoupling leads to unemployment in formalized economies and under-employment in less formalized ones.[87] In many countries, droughts, floods, or other natural disasters can have a similar impact. After the sources of the crisis dissipate, job creation picks up and unemployment or underemployment declines. The longer it takes for job creation to recover, the longer unemployment or underemployment lasts.

Decoupling can also occur in times of massive structural change brought about by rapid technical progress (for example, the introduction of computers) or policy reforms (for exam-

FIGURE 8.7 *Decoupling between job creation and job destruction was massive in the United States during recessions*



Source: Davis, Faberman, and Haltiwanger 2012.

ple, trade liberalization). Structural change can affect entire industries. In transition economies, such changes were enormous, as entire sectors economies had to cope with uncertainty and adapt to new incentives. Public sector restructuring or the privatization of state-owned enterprises can cause a similar shock. In all these cases, unemployment and underemployment can be large and long-lasting.

Losses in earnings and output are more pervasive with systemic shocks than with idiosyncratic shocks. But sometimes these two types of employment shocks can overlap. The recent financial crisis has led to an unusually deep recession in many countries. In the United States, high unemployment rates have persisted, unemployment spells have lasted longer than usual, and new job creation is still sluggish four years after the beginning of the crisis.[88] Some argue that the crisis is not a regular cyclical perturbation but the manifestation of a more enduring shift caused by technological change and globalization.[89]

Decoupling hurts

Protecting people should have primacy if shocks are idiosyncratic—if the employment dislocation is limited and if turnover continues to be the norm. A variety of social protection mechanisms exist that support people in their transition from one job to another. They concentrate on sustaining standards of living through unemployment benefits and public transfers. Learning new skills or relocating to where job opportunities are can also play a role. By moving from an adversely affected activity to another job, there is a gain in output that over time outweighs the cost of the support mechanisms. Protecting people is thus good for individuals and for society.

If massive decoupling occurs—through either a wider crisis or large-scale structural change—protecting workers will rarely be enough. Intermediation services falter because jobs are simply not available. Training may help individual workers land a job, but it does not create many jobs at the aggregate level, because it does not address the cyclical or structural causes of the employment shock. Income support through unemployment benefits and public transfers may suffer from inadequate funds or seriously affect fiscal accounts. Only sustained job creation can deal with the effects of decoupling, but even under the best of circumstances it may take several years to offset the employment decline from a systemic shock. The question then is whether providing income support on a large scale for long periods of time is preferable to temporarily supporting employment, while job creation picks up.

The long-term consequences and costs of decoupling can be higher than is usually thought. During periods of massive structural change, the reallocation of workers out of declining industries can lead to large output losses because little alternative employment is available. The productivity of jobs in declining industries may be low, but it can still be higher than the alternatives. Similarly, during crises, firms might not be insolvent but rather illiquid. Death of inherently solvent firms could cause loss of firm-specific human capital and intangible assets, disruption of value chains, and damage to surrounding communities. While the provision of credit would be the preferred solution, identifying insolvent firms might not always be feasible and could be marred by transparency problems. Temporary job protection policies can be a workable alternative to provide a lifeline for struggling, but inherently solvent, firms.

Long-term unemployment can also erode skills and workforce attachment. Aptitudes and attitudes to perform a given occupation can be lost.[90] "Scarring" can occur, with long-run consequences for finding employment with similar earnings.[91] Human capital and skills depreciate. Regardless of whether decoupling is the result of severe downturns or major structural changes, workers may enter a spiral of unappealing jobs and lower living standards. The potential costs might be particularly disruptive to social cohesion. Social networks can be undone in ways that make it more difficult for the dislocated to reengage in work and even in other forms of social activity.[92] Prolonged periods of high unemployment are of particular concern because they can affect young people's transition from school to work, and may lead to disenfranchisement from society.[93]

In some circumstances, then, job protection can be considered. What is meant by that is not permanent restrictions on hiring and firing through employment protection legislation, but rather time-bound policy measures that mitigate job destruction. In other words, these are selectively used active labor market policies that promote job creation or sustain existing jobs. Several countries adopted policies of this sort during the recent recession; Germany, which has a long tradition with such policies, averted job losses through a coordinated reduction of hours of work (box 8.8). The United States also took measures to protect jobs during the recent recession, most notably by salvaging its auto industry. But the United States relied mostly on aggregate demand stimulation and on extensions of unemployment insurance to protect workers, rather than on measures to protect jobs. In relative terms, changes in employment and unemployment in the United States were much larger than in Germany.[94]

The pitfalls of protecting jobs

There are examples in developing countries as well. Chile and Mexico introduced work-sharing policies and compensatory subsidies to moderate the impact of the crisis. But these policies had a limited impact in their case. Given their novelty, they required new procedures that were difficult to implement quickly, resulting in very low take-up rates. More important, these policies are not well suited to countries where a large share of employment is informal, because they fail to reach the vast majority of employers. The experiences of Chile and Mexico, two countries with relatively high administrative capacity that have made progress in formalization, suggest that the usefulness of work-sharing policies is limited in developing "countries."

There are positive examples as well. The different ways in which China and many Latin American countries handled the restructuring of their economies through the 1980s and 1990s are telling. At the beginning of its reform process, China had hundreds of thousands of uncompetitive state-owned enterprises (SOEs). But large-scale labor retrenchment would have pushed workers into even less productive jobs until the private sector developed sufficiently to absorb them. China thus supported its ail-

BOX 8.8 Kurzarbeit *has become a new word in labor market policies*

Kurzarbeit (which translates to "short work" or "reduced working hours") has been used in Germany for a century. Under this program, employees in participating firms can be asked to cut down on working hours with a commensurate reduction in compensation. The German government, through the Federal Employment Agency, covers a percentage of the ensuing wage loss. Participation of the firm is tied to the consent of the workers affected.[a] Thus there is an emphasis on social dialogue in the implementation of the program. During economic downturns, German employers tend to respond by reducing the number of hours worked, thereby mitigating the loss in jobs.

More than a dozen countries have adopted programs for reduced working hours based on the general *kurzarbeit* model but involving a variety of designs and regulations.[b] The countries where these programs were in place before the global economic crisis experienced substantial increases in take-up rates during the 2008–09 period.

As a response to the crisis, several countries implementing a work-share program increased the percentage of wages covered, extended benefit duration, and relaxed the criteria for qualifying for the program. In Germany, the period during which firms could request subsidies was extended from 6 to 24 months; the government coverage of social insurance costs was increased to 50 percent; temporary help workers were made eligible; and the program was allowed to cover up to 67 percent of wage losses incurred by affected employees.[c] It is estimated that more than 1 percent of permanent jobs were saved in Germany through *kurzarbeit*.[d] In 2009, more than 3 percent of the labor force was covered by the program.

The program is touted as beneficial in that it is less expensive for government to contribute funds toward paying the lost hours of work to the employee than to pay unemployment benefits. From the point of view of the employer, it helps retain skilled staff and reduces churning and retraining costs, thus maintaining firm productivity. From the perspective of the employee, the scheme prevents unemployment and the problems that come with it such as loss of income, depreciation of skills, decrease in life satisfaction, and insecurity. From the societal perspective, it cushions the impact of the economic downturn and spreads it more evenly across the labor force.

However, work-share programs only benefit formal sector employees, and not even all of them. The *kurzarbeit* is effective in saving permanent jobs but has no significant impact on temporary employment or on the hours worked by temporary workers.[e] Work-share programs are also more effective in countries with less flexible labor market regulations, where take-up rates are higher.[f] Furthermore, long-term reliance on this type of program can lead to significant delays in necessary labor reallocation and therefore could hinder growth and productivity in the medium term.

Source: World Development Report 2013 team.

a. If the adoption of the work-share program was foreseen in a collective agreement, the consent of the employees is not necessary; see Eurofound 2009.
b. These are Argentina, Belgium, Canada, Colombia, the Czech Republic, Denmark, Finland, Italy, Japan, Luxembourg, Mexico, New Zealand, Norway, Poland, and Turkey. See Hijzen and Venn 2011
c. Burda and Hunt 2011.
d. Cahuc and Carcillo 2011.
e. Cahuc and Carcillo 2011.
f. Robalino and Banerji 2009.

ing SOEs through access to banking credit while rapidly modernizing its economy, preventing social disruptions in the process.[95] Latin American countries also embarked on the dismantling of inefficient industries that had developed under import substitution policies. But they did so more abruptly. Sudden downsizing may have caused a more durable rise in informality and led to slower productivity growth.[96]

The risk with job protection policies is that they can create permanent inefficiency, especially in countries with weak institutions. Job protection policies involve firms or even whole industries that can coordinate to engage in rent seeking to secure permanent government support. If such policies are adopted, it is necessary to establish and enforce trigger rules and sunset clauses that define the extent and size of the protection. If the institutional prerequisites to ensure that support is temporary do not exist, or are not credible, job protection policies can be dangerous indeed. And they should not be considered at all if job losses do not result from a systemic employment shock, involving a large decoupling of job creation and job destruction.