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**Labor Market reform in Argentina:
Where do we stand?**

by

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1. Introduction

During the 1990s, Argentina did considerable progress in implementing market-oriented structural reforms. The reform package was based on three pillars: (a) a wide opening of the economy; (b) an ambitious privatization and deregulation program; and (c) the stabilization of prices based on a predetermined nominal exchange rate anchor, instrumented by implementing a monetary currency board in 1991 (*Convertibility Law*).¹ However, there was a shortfall in the fiscal accounts of the country during the decade, and hence, the stabilization achieved was feebly backed.²

Thus, during the last decade, there was a drastic change in the macroeconomic rules and inflation was overcome. However, towards the mid of the decade, the fiscal imbalances reappeared and, at the end of 2000, after three years of acute recession, the solvency of the state was severely questioned. Unfortunately, at the precise time of writing, in an economy under a harsh deflation, the government defaulted on its external debt.

The Argentine crisis and the failure of the package of reforms introduced during the 1990s will receive a great deal of attention in the next years. In this chapter, we would only like to note that, in the future, more attention should be posed on the intertemporal consistency of the economic policies adopted. At present, it is important to concentrate the reformist efforts exclusively on those institutions that are essential to the problems of the country.³ In our view, the priorities of the economic policy in Argentina are: (a) to achieve an equilibrium path of the country's fiscal accounts, and preserve the stability of prices; (b) to maintain those reforms made

¹ During the 1990s, Argentina did substantial progress in the following areas: 1) Privatization of State Owned Enterprises (SOEs): This program included most SOEs, and other state assets that were not operated previously as independent firms. A remarkable characteristic of the Argentine privatization program was its extent and speed (see Galiani and Petrecolla, 1996; and Galiani et al., 2001). 2) Trade liberalization: Major unilateral opening. Overall, the average external tariff in Argentina was reduced from a level of 45 percent in 1988 to around 12 percent in 1991. Most quantitative restrictions were also eliminated. Additionally, the dispersion of tariffs was substantially reduced (see Galiani and Sanguinetti, 2001). 3) Tax collection: The value added tax has become the main source of funding of the government. 4) Deregulation: Most domestic markets were deregulated during the 1990s. A financial reform that deregulated the domestic capital markets was also an important component of the package of reforms.

² There is absolutely no doubt that a prudent fiscal policy is a necessary condition to achieve a sustainable stabilization of prices. Naturally, there is no need to equilibrate the fiscal accounts in every year, although, after some prudent threshold, the real indebtedness of the government should not grow faster than real GDP (see Diamond, 1965). Indeed, this last condition was not satisfied in Argentina during the 1990s when the external debt grew from approximately 38 percent of GDP in 1992 to 50 percent of GDP in 2000.

³ Certainly, we agree with Stiglitz (2000) in that a reform agenda is not a statement of what an ideal economy might look like but rather the changes in institutions and policies that one might reasonably expect to be implemented, taking into account the capacity of its governments and its political processes.

during the 1990s that were successful; and (c) to rectify the pitfalls of the reforms adopted during the past decade. Retrospectively, Argentina still has to consolidate the reforms of first generation before embarking in the reforms of second generation (see Corbo, 2000). In the current situation, there is much uncertainty about the future evolution of the main macroeconomic variables in order to pursue successfully the reforms of second generation.

Overall, the 1990s have been a period of labor market deregulation in Latin America. Labor reforms have reduced the cost of dismissing a worker in a number of countries of the region. Payroll contributions did not change much even though pension reforms reduced fiscal pressure during the decade. Finally, unions have become weaker during the 1990s (cf. Heckman and Pagés, 2001). In the Argentine case, payroll contributions decreased substantially during the decade while the cost of dismissing a worker only decreased slightly. Unions' power also decreased during the 1990s, at least, in wage bargaining. However, unions still are an important and powerful political actor in the country.

To a large extent, the emphasis on decreasing payroll taxes in Argentina is the response to the unprecedented rise in unemployment that has taken place during the mid 1990s. In this way, the government tried to stimulate labor demand. Additionally, to stimulate job creation, the government legislated an extensive set of promoted contracts for new jobs during 1995. It is a standard view that this reform stimulated the creation of a large number of temporary contracts, which tended to dominate the flow of new jobs. However, after two years, there was concern about the volatility of these temporary jobs and the possibility that they have tended to generate excessive turnover in the labor market. This view has finally prevailed among policymakers and most of these contracts were ruled out during 1998 (see section 5). Besides, Argentina also reformed its pension system. However, as we discuss in section 5, this reform was flawed designed and it has been seriously affected by the recent default of the Argentine government on its debt.

During the 1990s, there were many changes in the labor legislation and labor market institutions in Argentina; however, these reforms did not completely fulfill the established agenda for Latin America (see, among others, Guash, 1999; and Loayza and Palacios, 1997). In the light of the recent experience, there appears to be scope to reconsider the reformist agenda for the labor market. A common pitfall in the labor market's reform agenda is that the

desirability of some components of it are based on a partial equilibrium analysis instead of an appropriate general equilibrium framework.⁴

In general, the objective to reform the labor market is to improve both static and dynamic efficiency. In what follows, taking into account these objectives, we analyze the progress made in reforming the labor market in Argentina during the 1990s. We also discuss which, in our view, are the priorities of the pending agenda.

2. The conventional agenda to reform the labor market

Almost all attempts to reform the labor market in Latin America during the last decade were based on a common established agenda. This agenda was based on the idea that the Latin American labor markets were rigid and needed to be more flexible. Essentially, the main argument was that labor market institutions were not flexible enough for the modern global economy (see, among others, Guash, 1999).

Flexibility measures do not need to be introduced by means of legislation exclusively. They may also be introduced by collective bargaining, individual employment contracts, unilateral action by employers or a combination of these methods.

Nevertheless, and even though there is no strong consensus among academics on how to design a package of reforms for the labor markets in Latin America, there was also a broad, well-established agenda of reform that we summarize as follows (see, e.g., Guash, 1999):

- 1. Collective bargaining.** Reduce the power of unions and increase the degree of decentralization of the bargaining process. Collective bargaining has to be decentralized at the firm level. Additionally, government intervention in wage-determination mechanisms and compulsory indexation of wages must be eliminated.
- 2. Job security.** Reduce job security. Employment protection legislation has to be reformed in order to increase the degree of labor market “flexibility”.
 - a. Severance payment system.** Reduce the cost of dismissing a worker by reducing both severance payments and notice periods. A reform commonly proposed is the following: Eliminate mandated severance benefits and replace them with a fully funded severance payment system (see Guash, 1999).

⁴ The importance of considering the general equilibrium impact of economic policies and programs has been recently emphasized by Professor Heckman’s work (see, e.g., Heckman and Smith, 1998).

- b. Contractual modes.** Allow for broader use of fixed-term contracts.
- 3. Payroll taxes.** Reduce payroll taxes.
- 4. Pension systems.** Replace the pay-as-you-go system with a privately managed full capitalization regime. This reform is supposed to reduce the tax wedge.
- 5. Workers' compensation insurance.** Adopt a workers' compensation insurance scheme in the event of a labor-related accident.

The analysis of the agenda

Even though there is academic consensus on the effect of some institutions on labor market outcomes, there is also disagreement. Theory not always yields clear-cut implications as to the relation between institutions and outcomes and the empirical evidence is not always conclusive. A typical problem is that often, a country's labor market institutions only vary across time and hence, it is difficult to identify their impact on labor market outcomes. Thus, an important part of our knowledge about the effect of labor market institutions is the result of cross-country studies. Having this caveat in mind, we now review the evidence that supports the labor market reform agenda.

Even though labor unions may be a productive force in society, unionism has undesirable effects. Unions push for higher real wages reducing the allocative efficiency of an economy (see Layard et al., 1991 and Pencavel, 1991). A second undesirable feature of unionism occurs when unions act in concert as a pressure group on democratic government and extracts benefits at the expense of other groups in society (see Pencavel, 1999). Thus, every country faces the challenge of organizing a system that minimizes the undesirable aspects of unionism and maximizes unionism's potential as a constructive element in society (see Pencavel, 1999).

There is substantial agreement among economists about the advantages of decentralizing unionism and collective bargaining. As summarized by Pencavel (1999): (a) collective bargaining at the enterprise level is less likely to generate wage pressure than collective bargaining at the industry-wide level. (b) Productivity-enhancing work arrangements at the firm level are more likely to be reached when the union has the authority for bargaining over wages at the firm level than when collective bargaining is at the level of the industry or higher. Additionally, higher competitiveness increasingly requires working out solutions to problems

that are well adapted to the specific circumstances of the firm. (c) The influence that unions exert as a pressure group on government is minimized if the locus of power of the union is at the local level and not at the economy-wide level.⁵ Moreover, when decentralizing collective bargaining, governments should leave as much as possible to be determined by the bargaining parties.

Thus, there is some evidence favoring the decentralization of industrial relations. Nevertheless, it is worth to point out that maintaining an industry-wide unionization structure and compelling national unions to bargain at the firm level may result in increased wage pressure and unemployment. Thus, when union coverage is high, decentralization of collective bargaining may result in higher unemployment rates. In reality, a competitive market environment provides the most effective constraint on wage and price monopolistic practices by unions and unionized employers. Hence, and irrespective of the progress made in decentralizing the industrial relations, there is a compelling case to foster product market competition in all sectors of the economy.⁶ Therefore, the crucial aspect to improve the working of the system of industrial relations is the introduction of competition in the economy. Consequently, to improve the system of industrial relations, we must take care of the rules and regulations throughout the economy, and not merely in the unionized sector (see Pencavel, 1999).

Indeed, there is a worldwide trend towards decentralization, notable not as much in the decline of central bargaining as in the growth of bargaining at the firm or workplace level. In particular, the search for greater flexibility in pay determination has tended towards decentralizing wage bargaining, strengthening the link between pay and performance, and attenuating the link between wages and prices (see Ozaki, 1999).

Regarding job security, the conditions under which a contract of employment can be terminated, are very different across countries. In some countries, the termination of a contract is severely restricted: Labor codes may mandate a minimum advance notice period prior to termination, determine which causes are considered 'just' or 'unjust' for dismissal and, establish

⁵ Some authors argue that wage bargaining at the centralized or industry level may create difficulties for low-productivity firms, whereas bargaining at the enterprise level can take better account of the particular conditions of the firm. Additionally, in an economy where human capital is highly specific, uniform regulations concerning wages and terms of employment applied to unique situations distort productivity.

⁶ For example, in a closed (non-competitive) economy, it is likely that a fully decentralized bargaining system reduces wage demands in comparison to a system of bargaining at the industry level. This follows because in a closed economy, the relevant elasticity of labor demand that is taken into account in wage bargaining is lower at the industry level than at the firm level. Contrary, in an open economy, a country's share of any industrial market is quite small. Thus, in a highly open economy, industry-wide bargaining may be only slightly more harmful than fully decentralized bargaining (see Layard et al., 1991).

a severance pay compensation for each possible cause of termination. In some countries, firms also must request permission to dismiss workers.

Formal models of dynamic labor demand do not yield clear-cut implications as to the relation between employment protection and main labor market aggregates, such as employment and unemployment rates and labor force participation. However, these models indicate unambiguously that employment should be more stable and individual employment relationships more durable when employment reduction is costly for employers (cf. e.g., Bertola, 1990, Hopenhayn and Rogerson, 1993 and Bertola and Rogerson, 1997). It is in that sense that firing costs make the labor market more sclerotic (cf. Bentolila and Bertola, 1990). Higher firing costs lead to worse labor-market conditions, in the sense of a lower exit rate from unemployment. It does not follow, however, that higher firing costs lead to a higher unemployment rate since in steady state, the unemployment rate is equal to the flow into unemployment times the duration of unemployment. Firing costs increase the latter but reduce the former having an ambiguous result on unemployment.

There is no robust evidence showing that employment protection influences overall unemployment although it seems that it raises long-term and reduces short-term unemployment (see, among others, Addison et al., 2000; Heckman and Pagés, 2001 and Nickell and Layard, 2000). Employment protection does, however, appear to reduce the employment population ratio. However, its impact is mostly on youths and females (with no impact on prime age males) (see, among others, Addison and Grosso, 1996, Heckman and Pagés, 2001 and Nickell and Layard, 2000). Furthermore, in developed countries, this result is driven by high employment protection and low married women's participation in southern Europe (see Nickell and Layard, 2000).⁷

Nevertheless, while employment protection may not lead to high unemployment, it may lead to lower output and lower productivity growth. The main argument here is that employment protection laws slow down the reallocation from old and declining sectors to new and dynamic sectors, thereby reducing the growth rate of the economy (see Hopenhayn and Rogerson, 1993).

⁷ Unfortunately, from a welfare perspective, the interpretation of the results on employment ratios for married women is not clear-cut.

Evidence shows that the rates of job destruction and job creation are similar among many European countries and the US.⁸ In most European countries, unprofitable jobs are close down and profitable ones started up at a reasonable rate despite the existence of high levels of employment protection. Worker turnover is higher in US than in Europe, which implies that workers rotate around existing jobs more rapidly. Whether or not this is particularly advantageous is not clear (cf. Nickell and Layard, 2000).

Furthermore, job security itself may aid to enhance productivity performance. There is evidence that, in many sectors, substantive employee participation is associated with high productivity growth and that the role of participation is much enhanced by a number of complementary factors, notably incentive pay and employee security (see Ichniowski et al., 2000).

Thus, the evidence in favor of reducing job security by reducing notice periods and/or severance pay is not overwhelming. Indeed, there are doubts about its advantages and disadvantages. Furthermore, broad reductions in employment protection run into strong political opposition since the most difficult sacrifice for workers in coping with labor market flexibility are undoubtedly those which concern their employment security.⁹

For this reason, governments have either done little, or tried to introduce reforms at the margin, allowing for reduced protection, but only for (some) new contracts. Therefore, the use of fixed term contracts seems to be a political substitute and not a complement to a reform of the severance payment system. Moreover, these contracts seem to be a perverse substitute (see Galiani and Nickell, 1999 and Blanchard and Landier, 2001). There is no reason to believe fixed term contracts will have much impact on unemployment for the reasons we have already discussed: Flows through the labor market may be increased but the impact on unemployment will probably be minimal.

⁸ Bertola and Rogerson (1997) suggest that this is due to the fact that while employment protection slows down the rate of job turnover, wage inflexibility at the firm level speeds it up.

⁹ It is worth noting that labor market flexibility does not exclusively imply a substantial reduction in the costs of dismissing a worker. It also refers, for example, to the ability of a firm (a) to adjust the level and timing of labor inputs to changes in demand, (b) to vary the level of wages according to the value of labor productivity, (c) to be able to design incentive payment schemes, and (c) to deploy workers between tasks to meet changes in demand.

In addition, Blanchard and Landier (2001) show that the result of such a reform may be lower productivity entry-level jobs, fewer regular jobs, and also lower overall productivity and output.¹⁰ They also show that even if unemployment decreases, workers may be worse off.

The danger of following the fixed term contract route to labor market flexibility is amply illustrated by Spain. In the early 1980s, fixed term contracts were introduced and by 1990 they had proved so popular that one third of all employees were on such contracts. Despite the enormous flexibility introduced by this change, it had absolutely no impact on Spanish unemployment. The existence of a large number of temporary employees simply raised the wage bargaining power of the permanent employees and their union representative, by adding to their security of employment. And since these employees bargain wages from everyone, this adds to inflationary pressure and maintains a high level of equilibrium unemployment (see Bentolila and Dolado, 1994).

Thus, we believe that there are good arguments against relying on the fixed term contract route to flexibility. If employment protection is to be reduced, it is much better to reduce it across the board than to create a separate class of workers on fixed term contracts (see Galiani and Nickell, 1999).

Regarding payroll taxes, Figure 1 presents a simple demand and supply model of the labor market which depicts the potential effects of payroll taxation. The upward-sloping relationship S_0 represents the supply of labor by workers in a world where the only tax existent is the payroll tax on firms; the downward-sloping relationship D_0 represents the demand for labor by firms that contribute with a payroll tax equal to t_0 on total wages. Furthermore, payroll tax revenues are not used to finance any program that only benefit workers. The equilibrium is achieved at (E_0, W_0) , where E is the level of employment and W is the nominal wage.

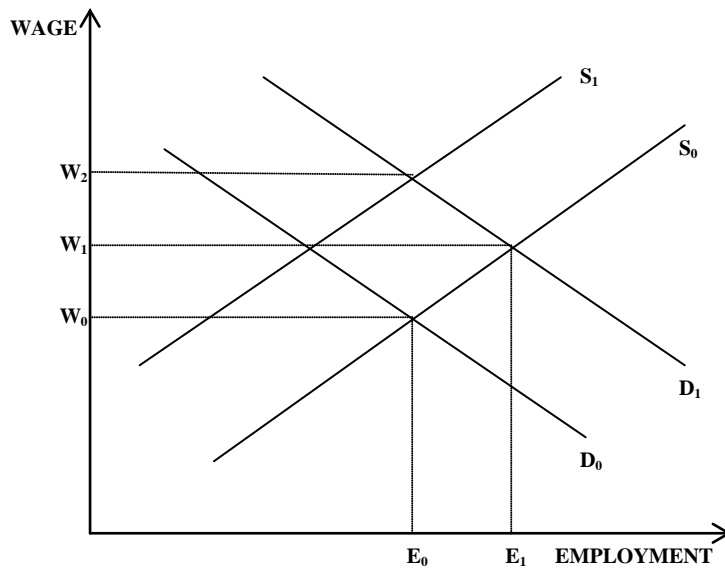
Consider a reduction of t_0 to t_1 . The demand curve shifts to D_1 , increasing the wage that workers are paid to W_1 , and increasing employment to E_1 . $(E_1 - E_0)$ is the disemployment cost highlighted by opponents of payroll taxation. The magnitude of this disemployment effect depends on the elasticities of labor demand and supply. Thus, in principle, reducing payroll taxes would increase employment.

¹⁰ This may be illustrated by a decision made in 1996 by Ford Motor Company in the United States that limited the number of its contingent workers to no more than 10 percent of the total workforce, after realizing that such workers can be a hindrance in operations that demand a flexible, well-trained workforce (see Ozaki, 1999).

However, things are more complicated. First, payroll tax revenues are often used to finance programs that only benefit workers. This restriction of benefits to workers creates an important tax/benefit linkage that also affects labor supply (see Summers, 1989). Second, a more realistic exercise is one where a reduction in the payroll tax is compensated by an increase in some other taxes. Now, consider a change in the tax structure. The government reduces t_0 to t_1 and legislates a value added tax. The demand curve shifts to D_1 , but now, the supply curve also shifts to S_1 . The nominal wage would increase but, in general, both the real wage and employment are not determined.

The general argument in favor of switching payroll taxes by consumption taxes is based on the fact that the former apply to labor income only while the latter apply to all spent income. Thus, a switch from payroll taxes to consumption taxes raises the reward for working relative to not working and thereby reduces unemployment. Thus, the crucial factor is the extent of income that it is not subject to non-labor to payroll taxation.

Figure 1: The incidence of payroll taxation



A more fundamental question is whether payroll taxes (or any taxes) have an impact on labor costs in the long-run. The evidence summarized in Heckman and Pagés (2001) for Latin America suggest that payroll taxes are shifted onto workers.¹¹ Similar evidence is summarized in Nickell and Layard (2000) for OECD countries even though they find that the tax wedge (i.e. the sum of income, consumption and payroll taxes) impact negatively on equilibrium unemployment.

In addition, many social programs, such as old-age pensions, health systems, unemployment insurance, and family allowances are funded from payroll contributions. The employment effects of mandatory benefits depend on whether workers value benefits at their cost and whether wages are free to adjust to offset benefits. The evidence summarized in Nickell and Layard (2000) for OECD countries suggests that the cost of mandated benefits is passed onto workers. Heckman and Pagés (2001) reach similar conclusions for Latin America. Based on the available evidence, it appears that at least in the long-run, funding these programs with consumption or income taxes instead of payroll taxes do not reduce employment costs much, but strengthening the tax/benefit linkage helps. This is the aim of the social security reforms.

Government pensions based on a pay-as-you-go system were subject to reform in several countries since the Chile successfully eliminated it and created a privately administered individual retirement account system in the early 1980s (see Edwards, 1998).

In a pay-as-you-go system, workers will consider the payroll contributions to be a tax on their labor supply. Nonetheless, in a pay-as-you-go program with stable growth, worker will, on average, receive some return on their contributions to social security –a return that is governed by the rate of growth of the economy. Thus, social security contributions are no just a tax. However, there is no necessary relation between the average and marginal returns on social security contributions. Thus, the smaller is a social security system's marginal tax/benefit linkage, the larger are the chances that privatizing social security can support an efficiency gain but if this is not the case, the efficiency gains from privatization are likely to be small, possible even negative (see Kotlikoff, 1998).

Regarding the adoption of a workers' compensation insurance scheme in the event of a labor-related accident, it may also enhance efficiency. However, there is concern that if the insurance system is not properly designed, the standard moral hazard problems of insurance may offset the efficiency gains of diversifying risk.

¹¹ See, especially, Gruber (1997).

Finally, even if it is excluded from the agenda of labor market reforms, there is a latent demand to assist the unemployed through the welfare system. The evidence is conclusive in this respect. There is ample evidence suggesting that there is a positive impact of benefit levels and entitlement duration on the length of individual unemployment spells (cf. e.g. Narendranathan et al., 1985 and Meyer, 1990).

3. The recent evolution of the Argentine labor market

A rigid labor market is characterized by low turnover rates and by wages unresponsive to the state of the labor market. However, this is not the picture that one obtains by glancing at aggregate statistics in Latin America. Latin American labor markets do not look sclerotic and there appears to be a realistic degree of wage flexibility. In particular, in Argentina both accession and separation rates are high. For example, the monthly inflow rate to unemployment has been over 2 percent since the beginning of the nineties, a number comparable to that of the US, and grew to 4 percent by the middle of the decade. Wages also exhibited a high level of responsiveness to the state of the labor market during the 1990s. Does this evidence imply that the Argentine labor market is flexible? To some extent, the answer must be affirmative: It appears that the Argentine labor market reveals certain flexibility. Nevertheless, this is not to say that there is no scope to improve the working of the labor market in Argentina. It only implies that the Argentine labor market has worked out its own way to flexibility.

3.1. The evolution of the labor market during the 1990s

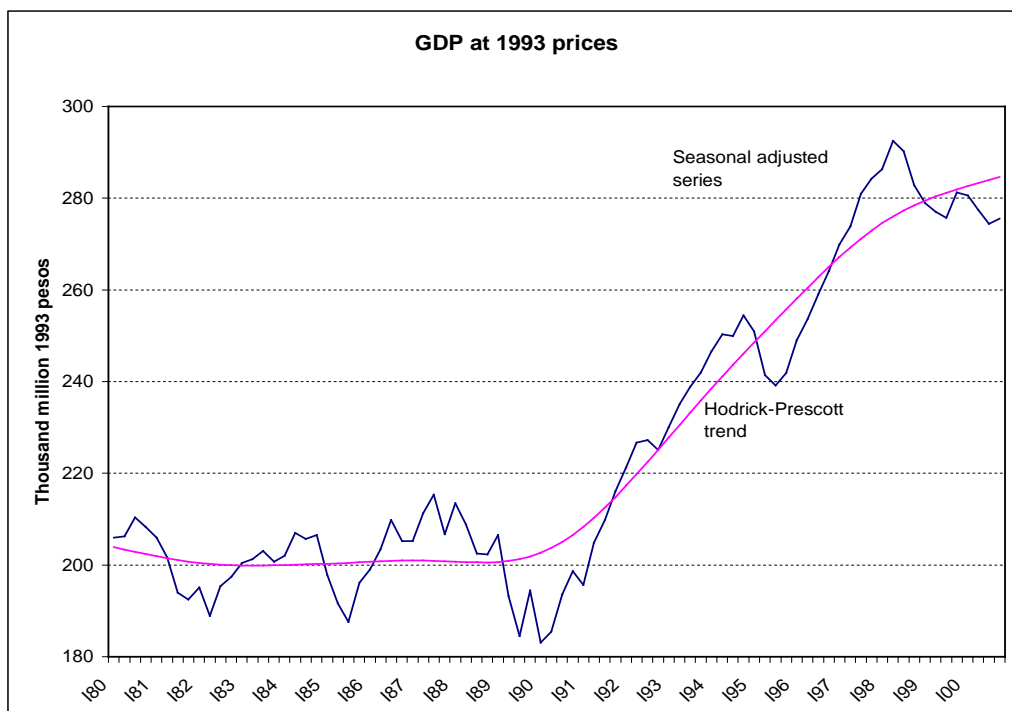
GDP grew substantially during the 1990s. Nevertheless, this growth was erratic, especially after 1994 (see Figure 2). In this context, the performance of the labor market has been deceptive. Unemployment has tripled during the decade (see Figure 3, panel d).¹² What is more, at the precise time of writing, unemployment has climbed again to the peak of the series.

¹² Pessino (1996, 1997) describes in detail the anatomy of unemployment in Argentina and the reader is referred to these papers for details.

Since the early 1990s, GDP growth accelerated significantly and total employment rose steadily until mid-1993. At this point unemployment started to rise (see Figure 3, panel d). During the second half of 1994, the economy slowed down (see Figure 3, panel c) and unemployment increased to 12.2 percent, starting from a level already as high as 10 percent.

Although the economy was already in a mild recession during the second half of 1994, conditions worsened substantially after the devaluation of the Mexican peso during December 1994. Domestic demand and output contracted abruptly: GDP declined nearly 5 percent in 1995 (see Figure 3, panels a and c).¹³ This shock had dramatic effects on unemployment. With the labor force expanding and employment falling sharply along with aggregate demand, unemployment rose by over 6 percentage points in six months (see Figure 3, panels b and d).¹⁴

Figure 2: GDP –Seasonal adjusted- and its HP Trend



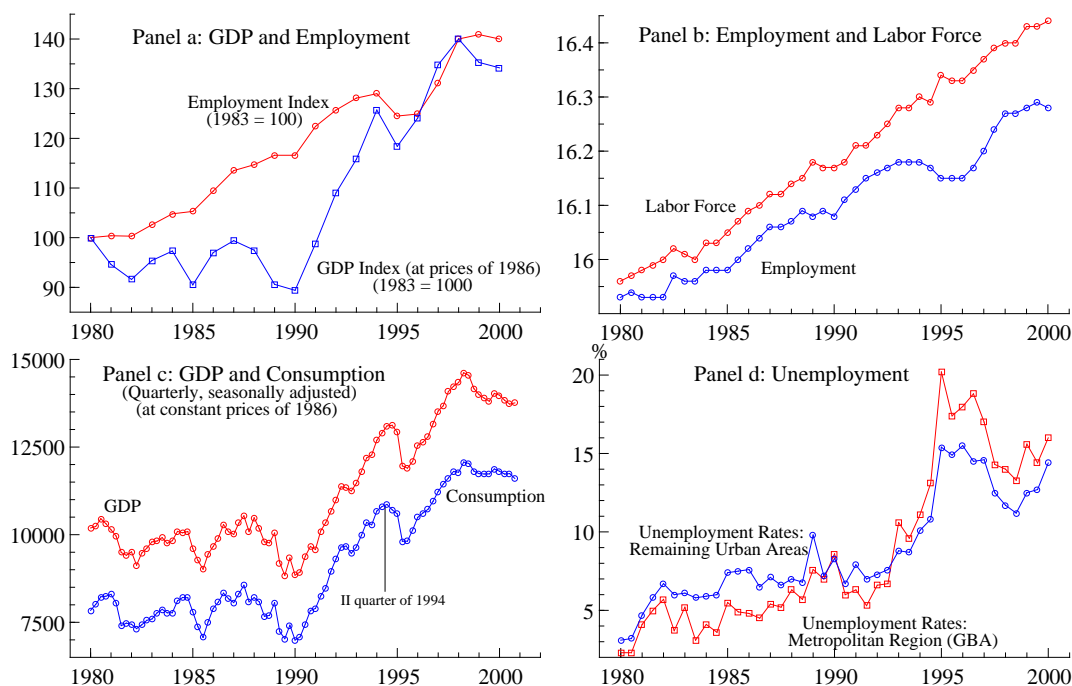
The recession was short despite its severity. The economy soon recovered and, between 1996 and 1998, both output and employment grew rapidly with a substantial decline in the

¹³ The severity of the contraction is seen by observing that between the last quarter of 1994 and the third quarter of 1995 domestic demand decreased 14 percent, investment fell 30 percent while GDP decreased 10 percent

¹⁴ Indeed, the labor force grew fast during the whole period.

unemployment rate. However, at the beginning of 1999, the Brazilian currency underwent a strong depreciation. The economy contracted 4 percent in 1999 and unemployment increased again. Thus, unemployment has been well above its equilibrium level during the 1990s, that is, above the equilibrium level implied by its wage and price setting institutions, mainly due to a combination of macroeconomic shocks and labor shedding in the manufacturing sector.¹⁵ Although it has been argued that the high level of unemployment during the 1990s is the result of the reduction in the capital-labor price ratio that resulted with the elimination of the tariffs of the capital goods at the beginning of the decade, simple evidence shows that such is not the case.¹⁶

Figure 3: The Argentine economy in recent years.



Sources: Panel a: ECLA and INDEC press reports; b: household survey, all urban agglomerates; c: ECLA; d: INDEC Press Reports.

¹⁵ There were reasons to expect that labor reallocation took place during the 1990s, as the privatized firms reduced their employment and, most importantly, the manufacturing sector faced stronger foreign competition.

¹⁶ It is sometimes argued that the rapid productivity growth of the early 1990s generated high unemployment because if output growth remains fixed, higher productivity growth leads to lower employment growth. In fact, of course, output growth does not remain fixed. Under sensible macroeconomic policies, output will expand with the supply potential of the economy.

The manufacturing and, electricity, gas and water sectors have been shedding labor between 1992 and 1995. However, in general, employment in the remaining sectors of the economy grew during most of the years but 1995 (see Table 1). This evidence contradicts the hypothesis that the reduction in the capital-labor price ratio was the main cause of employment destruction during the 1990s since if this were the case; we should observe the similar pattern of employment behavior across industries.

Indeed, at the industry level, job creation has been high in every year in which growth was high. In that respect, 1994 is the only exemption, but the economy entered a recession during the second semester even though exports were growing fast and GDP did not decreased until 1995 (see Figure 3, panel c). Finally, the period 1996-1998 is one of exceptional employment growth.

Table 1: Change in employment (thousands)

Industry	Year										
	87-88	88-89	89-90	90-91	91-92	92-93	93-94	94-95	95-96	96-97	97-98
Manufacturing	-7.3	-36.5	-43.6	-0.2	52.9	-41.7	-78.6	-95.9	-17.6	78.9	-8.4
Electricity, gas And water	2.3	-3.2	12.8	8.8	-3.0	-16.4	-2.6	4.6	-2.5	-2.8	-5.1
Construction	30.3	-49.8	-32.9	50.0	7.7	-16.0	20.6	-10.2	11.3	62.3	38.9
Trade	39.5	-4.3	-1.1	85.3	61.6	21.4	13.0	-27.6	33.6	-27.6	58.1
Transport and communications	18.9	37.8	-19.3	-27.0	8.4	54.3	32.6	2.8	4.5	22.5	42.4
Finance	-0.5	5.8	-21.9	28.0	5.6	4.0	53.4	18.4	21.2	43.1	44.5
Community services	1.3	-1.5	49.3	-13.1	5.0	51.7	-83.1	45.7	-29.7	216.4	222.5
Total change	84.5	-51.6	-56.7	126.7	138.2	57.4	-44.8	-62.2	20.8	392.9	392.8
Total change as percentage of total employment	1.8	-1.1	-1.2	2.7	2.8	1.1	-0.9	-1.2	0.4	7.9	7.3
Job creation	92.3	43.7	62.1	167.1	141.2	131.5	119.5	71.5	70.6	423.3	406.3
Job destruction	7.8	95.3	118.8	40.3	3.0	74.1	164.3	133.7	49.8	30.4	13.5
Job turnover as percentage of total employment	2.1	2.9	3.8	4.4	3.0	4.1	5.6	4.1	2.4	9.1	7.8

Source: Galiani and Nickell (1999).

3.2. Real Wages

In this subsection we analyze which was the response of real wages to the substantial increase in unemployment. The responsiveness of real wages to unemployment is a fundamental parameter in macroeconomic analysis. A higher degree of wage flexibility implies, *ceteris*

paribus, a lower equilibrium unemployment rate (see, e.g., Blanchard and Katz, 1997, Layard et al., 1991 and Pissarides, 1990).

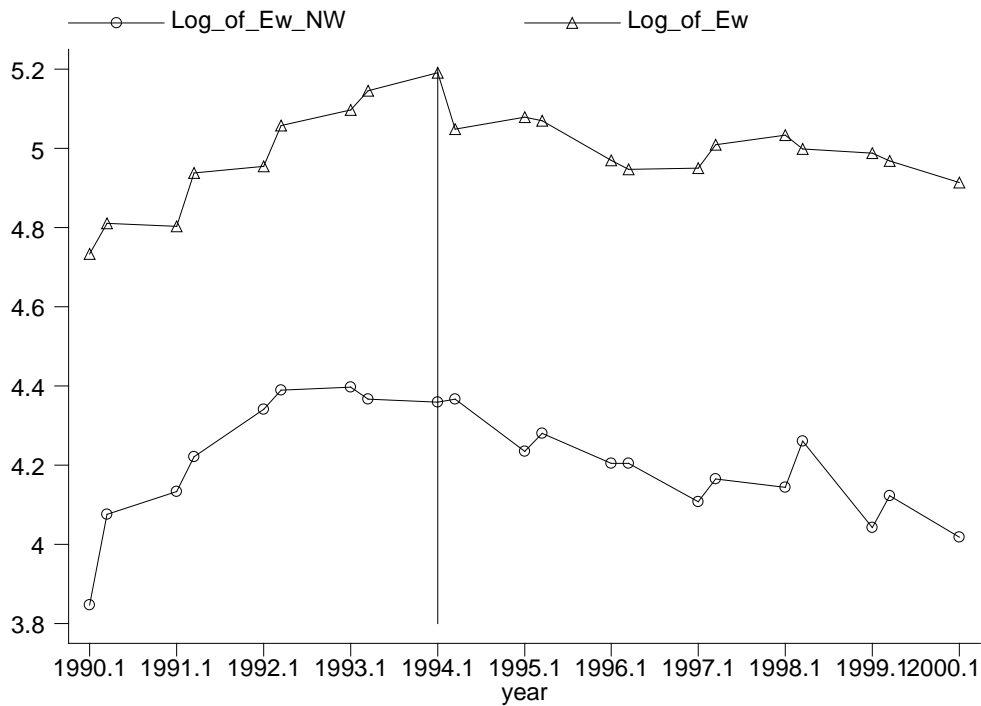
In the main urban agglomerate, Greater Buenos Aires, male employees' real wages decreased approximately 10 percent between the first wave of the household survey in 1994, when unemployment started to increase substantially and real wages peaked, and the first wave of the household survey in 2000.¹⁷ Nonetheless, Solon et al. (1994) show that the true procyclicality of real wages is normally obscured in aggregate time series analysis due to the existence of composition biases. They show that aggregate statistics are constructed in a way that gives more weight to low-skilled workers during expansions than during recessions. To circumvent this problem, we compute two alternative statistics that do not depend on the cyclical composition of observable characteristics of the employees. Thus, to estimate real wages, we condition the logarithm of the individual real wages for Greater Buenos Aires on a set of industry affiliation dummy variables, a set of dummy variables capturing the educational attainment of the individual and a quadratic polynomial in potential experience and constraint the sum of each set of dummy variables to be zero in the regression functions we estimate (see Suits, 1984). In this way, the constant in the regression function estimate the expected wage for a worker with no labor market experience (i.e. no potential experience). Finally, to obtain an estimate of the expected real wages, we evaluate the estimated polynomial in potential experience at the sample average level of potential experience and add it to the (transformed) constant. Figure 4 presents the time series of these two statistics.

We find that our estimates of real wages show a much higher decline after unemployment increased. Expected real wages decreased approximately 24 percent between the first wave of the household survey in 1994 and the first wave of the survey in 2000.¹⁸ Additionally, we estimate a similar behavior for the average expected wage for the 25 urban agglomerates where the household survey was carried out during the whole decade. Finally, the expected wage for a worker with no labor market experience declined even more during the same period. Thus, irrespective of the statistic considered, we find a high response of real wages to the deterioration of the conditions of the labor market.

¹⁷ Our sample is drawn from the household survey for Greater Buenos Aires. The survey is a rotating panel in which 25 percent of the sample is replaced in each wave of the survey, which is conducted twice per year.

¹⁸ This result is unaltered when the earnings equations control for possible self-selection.

Figure 4: Expected Log of real wages at prices of April, 1990
(New entrants workers and workers with average potential experience)



Notes: Monthly wages correspond to male employees.

3.3. Worker turnover

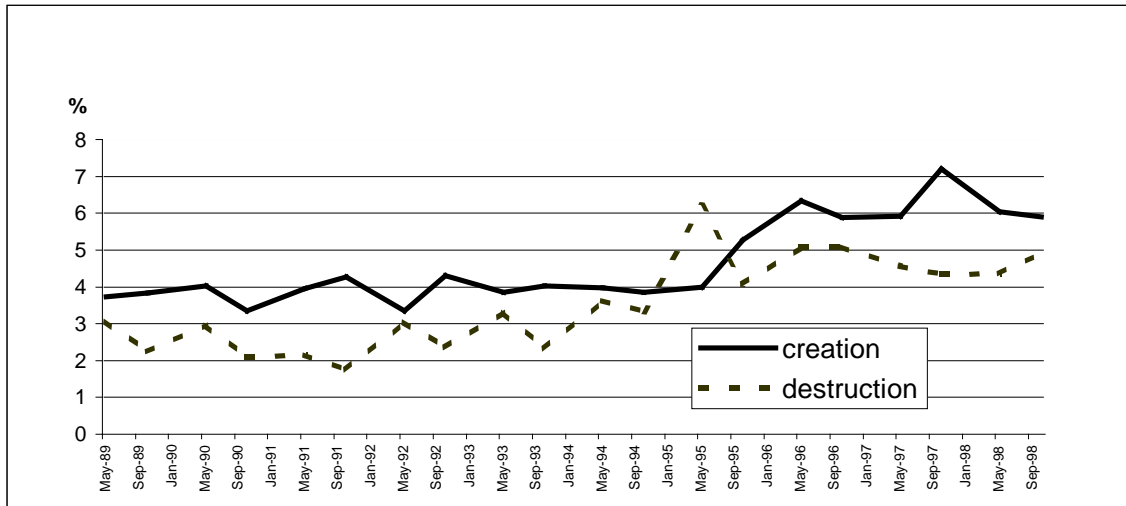
Figure 5 provides standard estimates of creation and destruction flows for job matches. The rate of match creation is measured by the ratio of employed workers with less than one month of tenure to the stock of employed workers. The rate of destruction is measured by taking the ratio of unemployed workers with less than one-month duration to the stock of employed workers.¹⁹

These flows are fairly constant up to 1994. The severe recession in 1995 results in a large shock to match destruction, which is then followed by a steady increase in creation. After 1995, both flows stay at values of at least 50 percent larger than those experienced during the first part

¹⁹ Thus, job destruction is slightly overestimated since there are workers entering unemployment from out of the labor force.

of the 1990s. The breakpoint (1995) is a recession year, but also the beginning of the period where fixed term contracts were available.

Figure 5: Match creation and destruction
(1 month)



3.4. Long-term unemployment

A standard method to evaluate unemployment risk is to consider the incidence of unemployment and its duration. Even when the incidence of unemployment may be high, it is usually understood that if unemployment spells are short-lived, the social cost of a typical unemployment spell is low. However, this reasoning is misleading when the typical employment spell is also short-lived. In such case, a correct account of unemployment risk must take into consideration the re-incidence of unemployment spells. Galiani and Hopenhayn (2000) estimate that, for the Buenos Aires labor market, contrary to the view that unemployment spells are short, total expected duration, accounting for repeated spells, is indeed long.

Table 3: Unemployment rates in OECD and Argentina (%)
1989-1998

Country	Total unemployment rates	Short-term unemployment rates	Long-term unemployment rates	Long-term unemployment incidence rates
Spain	19.8	9.3	10.5	53.2
Ireland	13	4.9	8.1	62.1
Finland	11.7	8.9	2.8	23.9
France	11.1	6.7	4.3	39.3
Italy	9.7	3.4	6.3	65.1
Germany ^a	9.1	4.6	4.5	49.8
Denmark	9	6.5	2.5	27.7
Belgium	8.6	3.2	5.4	62.4
United Kingdom	8.4	5.1	3.2	38.6
Netherlands	6.4	3.3	3.2	49.5
Sweden	6.3	4.9	1.4	21.9
Portugal	5.6	3.1	2.6	45.4
Norway	5	4	1	19.7
Switzerland	2.8	2.1	0.7	25
Japan	2.8	2.3	0.5	18.8
Australia	8.8	6.1	2.7	30.3
New Zealand	8.0	6	1.9	24.3
Canada	9.6	8.5	1	10.6
US	5.8	4.9	0.9	15.1
Argentina	11.6	9.8	1.8	16

Notes: These rates are OECD standardized rates with the exception of Denmark and Italy. The data for Argentina refer to the Metropolitan region and follows the ILO definition. Hence, these rates are very similar. Long-term rates refer to those unemployed with duration over 1 year.

a) Period 1995-1998.

Sources: Authors elaboration based on Nickell and Layard (2000), OECD Employment Outlook (1999) and the Argentine Household Survey (GBA).

Table 3 presents average unemployment rates as well as short and long-term unemployment rates for OECD countries along with the Argentine figures for the period 1989-1998. This data shows that the incidence of long-term unemployment in Argentina is substantially lower than in most European countries and it is similar to that of the US. Notice that, for example, the incidence of long-term unemployment for the OECD countries with average unemployment over 10 percent is 45 percent, three times the Argentine incidence rate. Thus, Argentina seems to be a country where unemployment is mostly a short-term phenomenon. Galiani and Hopenhayn (2000) study the conditional distribution of total unemployment time for a two-year period. Using panel data from household surveys for the Buenos Aires area for the period 1989-1998, they estimate a Markov process for transitions from employment to unemployment (and vice versa) that allow for duration dependence. From these estimates they simulate the stochastic

process (i.e. they conduct a Monte Carlo exercise) and find that of all workers unemployed at a given point in time, 34 percent spent more than one year of unemployment during the past two years. These figures are much closer to the high numbers found in European economies.²⁰ Thus, as we see in the next section, although Argentina lacks a well-developed system of unemployment insurance, the incidence of long term unemployment once re-incidence of unemployment spells are taken into account is high.

4. Labor Market institutions compared²¹

In this section we analyze the Argentine labor market institutions by relying on a series of cross-country comparisons. Our objective is to improve our understanding of the labor market institutions included in the reform agenda. Thus, we also include in the analysis certain parts of the tax system.

4.1. Taxes on labor

Taxation on labor typically operates via the wedge between the real cost of a worker to an employer and the real consumption wage of the worker. Consider a representative firm in a closed economy producing GDP. The real labor cost per worker is W/P where W is nominal labor cost per worker and P is the GDP deflator (at factor cost). The corresponding consumption wage is $W(1-t_1)(1-t_2)/P(1-t_3)$ where t_1 is the payroll tax rate, t_2 is the income tax rate and t_3 is the consumption tax rate. The tax wedge is $(1-t_1)(1-t_2)/(1-t_3) \cong [1 - (t_1+t_2+t_3)]$ (cf. Nickell and Layard, 2000).

In table 4, we present some information on tax rates across the OECD and in Argentina. In the first column, we have the payroll tax rate, defined as the ratio of labor costs to wages (less unity). Note that this tax includes all employers' mandated payments like their contribution to

²⁰ Of course, someone could argue that long-term unemployment is also higher in Europe once unemployment re-incidence is taken into account. However, the impact of re-incidence on long-term unemployment in Europe is likely to be of second order compared to its impact in Argentina since in Europe long-term unemployment is already quite high. In any case, it is clear that long-term unemployment in Argentina is not ignorable once re-incidence is taken into account, which is the point we want to stress here.

²¹ This section draws heavily on Galiani and Nickel (1999).

the employees' health insurance. Nevertheless, if the willingness of workers to work is largely unaffected by decreases in money wages accompanying the provision of employer payment of health insurance, the cost of a mandate will fall almost entirely on workers in the form of lower wages and the tax wedge will be unaffected. In the second column, we add to the payroll tax the average income and consumption tax rates derived from aggregate tax and income data.²²

Table 4: Tax rates on labor

	1 Payroll tax rate (%) t_1	2 Total tax wedge (%) ($t_1 + t_2 + t_3$)
Austria	22.6	53.7
Belgium	21.5	49.8
Denmark	0.6	46.3
Finland	25.5	65.9
France	38.8	63.8
Germany (W)	23.0	53.0
Ireland	7.1	34.3
Italy	40.2	62.9
Netherlands	27.5	56.5
Norway	17.5	48.6
Portugal	14.5	37.6
Spain	33.2	54.2
Sweden	37.8	70.7
Switzerland	14.5	38.6
UK	13.8	40.8
Canada	13.0	42.7
US	20.9	43.8
Japan	16.5	36.3
Australia	2.5	28.7
New Zealand	-	34.8
Argentina (pre 1996)	33.0	49.2
(1996)	23.8	40.0

Notes: (1) Centre for Economic Performance (LSE) OECD data set. Defined as the ratio of labor costs to wages (less unity). Note that this include pension and other mandated payments by employers. Argentina: employer mandated payments as a percent over wages: pension system 16, employees' benefits (family assignments): 7.5, Employment National Fund: 1.5, health insurance (*obras sociales*): 6 and National Institute of Pensioned Social Services (health insurance elderly): 2. Since 1996, employees' health system contributions were reduced to 5 percent while the other mandated payments have been reduced between 30 and 80 percent depending on the geographical area. We compute the payroll tax applying the tax reduction of Greater Buenos Aires (approximately 30 percent). The figures pre-1996 are computed under the tax/wage legislation of 1995. (2) Centre for Economic Performance (LSE) OECD data set. Defined as the sum of the payroll tax rate, the income tax and the consumption tax rate. The latter are average rates derived from national income accounts including total tax receipts from different types of taxes. Argentina figures refer to 1995. t_1 is estimated from the aggregate information provided in Duran and Collar (1996), tables 2 and 3. t_3 Duran and Collar (1996) table 2 provides the 1995 figures for indirect taxes as proportion of GDP. We multiply this figure by the GDP to consumption ratio (at 1996 prices) to obtain the indirect tax rate. (3) The OECD data is for the period 1989-1994.

²² Additionally, some authors also include in the tax wedge other employees' mandated payments like their contribution to the pension system or to the health insurance. We follow Nickell and Layard (2000) and only include the employers' contributions. In Argentina, the employee contribution is 17 percent of the wage (pension system, 11; health insurance, 3 and health insurance elderly, 3).

The key features of these numbers are first, the enormous variation in payroll tax rates stretching from Denmark, where the government levies no social security taxes on firms, to France and Italy with rates close to 40 percent. Second, while there is less variation in the other two columns, it is clear that the total rates in Europe are, with the exception of the UK, Switzerland and Portugal, higher by 10 to 20 percentage points than the other countries, with the Nordic countries being the highest of the lot. This is the consequence of higher levels of public expenditure in continental Europe than elsewhere. Finally, although the pre-1996 tax wedge in Argentina was comparable to the continental European level, after the significant reduction of 1996 arising from the cut in payroll taxes, the total tax wedge is now below the continental European level and is on a par with the OECD countries outside Europe. The payroll taxes in Argentina are just above the median OECD rate.

4.1. Trade Unions and wage bargaining

Most workers in the OECD outside the US have their wages determined by collective agreements that are negotiated at the plant, firm, industry or national level. In the first two columns of table 5 we present the percentage of employees who belong to a trade union and an indicator of the percentage of workers covered by collective agreements (3 means over 70 percent, 2 means 25-70 percent, 1 is under 25 percent). The main point that emerges here is that even if the number of union members is very low, as in France and Spain, it is still possible for most workers to have their wages set by union agreements. This occurs because, within firms, non-union workers typically get the union negotiated rate and because, in many countries, union rates of pay are legally “extended” to cover non-union firms. In Argentina around 45 percent of employees belong to a union and half the employees are covered. The latter places Argentina somewhere between Europe and the US. However, we shall note that, on the one hand, public servants employment relationships in Argentina are normally regulated by particular legislation or statutes and are not typically covered by a collective agreement although they are mostly unionized. On the other hand, workers in small firms (<25 workers) are typically not represented by a union although they may be covered by a collective agreement (data obtained from the

Household Survey Supplement, 1990). In general, in small firms there is no union representative and the collective agreement is not operative.

Table 5: Trade Unions and Wage Bargaining

	1 Union Density (%)	2 Union Coverage Index
Austria	46.2	3
Belgium	51.2	3
Denmark	71.4	3
Finland	72.0	3
France	9.8	3
Germany (W)	32.9	3
Ireland	49.7	3
Italy	38.8	3
Netherlands	25.5	3
Norway	56.0	3
Portugal	31.8	3
Spain	11.0	3
Sweden	82.5	3
Switzerland	26.6	2
UK	39.1	2
Canada	35.8	2
US	15.6	1
Japan	25.4	2
Australia	40.4	3
New Zealand	44.8	2
Argentina	45.0	2

Notes: (1) OECD Jobs Study (1994), table 5.8, column 3. Trade union members as a percentage of all wage/salary earners. OECD: 1989-1994. Argentina: 1991/4, Feldman (1995). (2) Layard, et al (1991), annex 1.4 and OECD Employment Outlook (1994a), pp. 175-85. Union coverage is an index, 3 = over 70% covered, 2 = 25-70%, 1= under 25%. Argentina: 1995, FIEL (1997).

In Argentina most workers whose pay is covered by a collective agreement have their wages determined, at least initially, by industry-wide bargains struck between a national industry union and one or more employers' federations. Further wage agreements may be struck at lower levels right down to the firm level using the industry-wide agreement as basis.

Nevertheless, collective bargaining has been seriously affected since 1975 in Argentina. It is worth to note that from 1976 to 1988 collective bargaining was not authorized although since then it has been unfettered. In addition, like in other countries, a collective agreement remains in force until a new agreement is signed. In 1997, 46 percent of the collective agreements in force were signed in 1975 and ten of this agreements covered 55 percent of the population subject to collective agreement coverage. Naturally, wages have been renegotiated recurrently. Certainly, if it were the case that only wages were renegotiated while the rest of the norms were even informally in force, at least in an economic sense, these wage agreements would constitute a

renegotiation of the collective agreements. However, Goldin (2001) reports that most of the norms of the agreements signed in 1975 are not fulfilled and also, that there are informal agreements at the firm level that modifies the collective norms.

Unfortunately, in Argentina, there is not a well-developed field of labor relations' studies. Thus, the knowledge we have about the Argentine labor relation system is less than desirable. We exploit a data set of ten percent of the agreements in force and find the following general characteristics: 1) these agreements usually last for 18 months, although in the recent years the average duration of the collective agreements has increased. 2) Unions do not bargain the level of total employment in their industry or firm; the employer has the unilateral right to fix the total number of jobs. However, 3) unions may (indirectly) influence the number of jobs. A fraction of the collective agreements analyzed negotiates work rules that attempt to control the capital-labor ratio (manning levels, and crew sizes). 4) The most widely used method for choosing who in a slump will be made compulsorily redundant is 'last in, first out' (LIFO or layoff by seniority). Oswald (1987) finds similar results for both UK and US, although in the latter country collective agreements last longer. In table 6 we present additional information about the characteristics of collective agreements in Argentina.

Since 1991, collective bargaining at the firm level has been increasing at the same time that bargaining at the industry level has been vanishing. The impulse to the firm level bargaining has arisen as a result of the privatization of the state owned enterprises and in new large firms. Nevertheless, overall, the coverage of the bargaining has decreased substantially. Thus, between 1988 and 1998, the signed collective agreements only cover 5 percent of the employees. Nonetheless, there is a mild trend towards decentralization of collective bargaining that is still obstructed by the structure of the industrial relations in Argentina (see Aldao Zapiola et al, 1994, MTSS, 1995, 1997). Indeed, the most innovative changes in collective bargaining have been introduced in firm level agreements during the last decade. Thus, for example, a substantive proportion of the firm level agreements bargained lately incorporate pay per performance rules.

**Table 6: Proportion of agreements that bargain a working rule
Coverage by level of negotiation
(Argentina, 1975-1998)**

Coverage	Manual workers % of agreements that bargain the working rule	
	Industry level	Firm level
1. Physical working conditions	67	77
2. Redeployment within establishment	68	61
3. Manning levels and Crew Sizes	13	5
4. Layoffs and Redundancies	23	37
5. Recruitment	70	78
6. Holiday entitlement	62	51
7. Length of working week	62	66
8. Wages	94	90
9. Pensions	17	15
10. Human and physical capital investment	19	32

The coverage includes ten working rules: 1. Physical working conditions: includes Security, Hygiene and Equipment; 2. Redeployment within the establishment: promotions, and re-employment; 3. Manning level, and crew sizes (constraints on capital-labor ratio); 4. Layoffs and Redundancies: discharges, suspensions, and staff reduction for economic reasons; 5. Recruitment: vacancies, and recruitment; 6. Holiday entitlement: holidays, vacations, and weekly rests; 7. Length of working week; 8. Wages: nominal wage; 9. Pensions: pensions, and extraordinary contributions to the staff who have the conditions to be retired; 10. Human and physical capital investment: technological improvements, and training.

Source: Argentine Law and authors elaboration.

A key feature of the Argentine system of industrial relations is that the state confers union status (*personería gremial*) determining who represents workers in collective bargaining in a certain industry or craft. The legislation centralizes the collective bargaining. There is a unique union that is granted legal status to represent workers in an industry. Therefore, there is only one union (or federation) owing the monopoly to represent workers.²³ For example, a union at the firm level cannot represent the workers of that firm if an industry-wide union represents them.

Thus, although collective bargaining is practically not operating, industry-wide unions dominate the labor relations in Argentina. Unions are still economically powerful and are the main force opposing labor market reforms in Argentina. Unions receive worker contributions

²³ There is only one union (or federation) by industry that has the right to negotiate in representation of all workers. Although this right is granted to the most representative union, in practice, there is no chance to challenge the dominant position of the incumbent union.

negotiated in collective agreements and may as well receive firm contributions bargained in collective agreements.

Additionally, Argentine unions own an even more powerful resource to sustain their growth: the administration of the workers health insurance system. This system originally developed by collective bargaining at the end of the 50s. Employers agreed to contribute to the funding of the system while unions imposed statutory contributions to their members. During the early 60s, the government created by law a health insurance systems for some industries and some state government employees. Finally, in 1969, the law 18.610 established the creation of a mandatory system for all workers that is financed by the contribution of both employers and employees irrespective of whether or not the latter are union members and that is administrated by the union signatory of the collective bargaining. The administration of the system, in addition to providing unions with substantive financial resources, has been a source to maintain union density at high levels, specially in industries where direct control of affiliation by the syndicate is too costly, like it is the case of industries with small average size of firms (i.e. the trade sector).²⁴

4.3. Employment Protection

The main regulatory frame of the employment relationship is the contract of employment law (20.744) passed in 1974, modified in 1976 (law 21.297). We refer to both laws and their respective regulatory decrees as the contract of employment law.

The contract of employment law is the main institution in the labor law. Nevertheless, some worker's contracts are not regulated by the contract of employment law, like those of the rural workers, domestic servants and civil servants.²⁵

The general rule upheld by the contract of employment law is the principle of continuity of employment contracts. Employment contracts are settled for an indeterminate period of time. However, this conceived stability of jobs by the law is not absolute. Much to the contrary, any employer has the right to end an employment contract without expressing any cause at all. To dismiss an employee, the employer only has to give the employee advance notice and pay him or her a legislated severance pay that depends on the worker's wage and tenure.

²⁴ Union members have always been granted privileged attention in the system over non-union members.

²⁵ The administrative law instead of labor law regulates civil servants employment relationships. Law 22.248 regulates rural workers contracts.

The contract of employment law basically admits the following termination options (we focus only on the causes instated by the employer):

a) Without cause: Notice period: one month when the workers' tenure is at most five years and two months otherwise. The notice period starts at the beginning of the calendar month. Pay in lieu of notice is available. Severance pay: Equivalent to a monthly gross wage per year of tenure or fraction greater than a quarter year. The severance pay per year should not exceed three times the monthly average wages agreed in the collective bargaining that applies to the employee. Finally, severance pay cannot be lower than twice the best gross wage the employee received during the previous year.²⁶

b) Disciplinary dismissal: Neither notice period or severance pay apply.

c) Technological or economic reasons: No notice period. Severance pay is reduced fifty percent. However, since 1991 there is a bargaining period of 10 days intended to prevent massive layoffs. Other types of ordinary contracts are the following: a) Fixed-term. Duration: indeterminate, but limited: at most five years. Severance pay does not apply if the contract is terminated at the agreed time. b) Discontinuous. Duration: indefinite, but work is performed only during certain periods of the year. c) Part-time (regulated in 1995 but not forbidden before).

In table 7 we report some information on European employment protection laws alongside those of Argentina. Note that in all these rankings, a higher number means a stricter system. As we can see, Argentina has a relatively generous system of advance notice and severance pay. Additionally, it is worth to note that Argentina lacks a set of rules governing fixed term contracts. On the other hand, the actual procedures are straightforward. Overall, Argentina lays about half way the map, well below the strict systems of Southern Europe but offering more job security than is standard in North America.

Heckman and Pagés (2001) construct a cardinal measure of firing costs that attempts to reflect the marginal of dismissing full-time indefinite workers. The key elements included in their measure are advance notice requirements and compensation for dismissal with and without cause. Not surprisingly, on these dimensions, Argentina's job security regulations are very strict.

²⁶ Domestic servants: severance pay is equivalent to half the monthly wage per year of service. Notice period is at most ten days. Civil servants: severance pay is a strictly concave function in tenure and notice period is replaced by a scheme more favorable to them. Additionally, in the case of construction workers, the severance pay is replaced by an insurance scheme.

Table 7: Employment Protection
Indicators of the “strictness” of employment protection legislation
Values of the Indicators

	Regular procedural Inconveniences		Notice and severance pay for no-fault Individual dismissals						Difficulty of dismissals			
	Procedures	Delay to start of notice	Notice period after			Severance pay after			D	Trial Period	At 20 y	R
			9 m	4 y	20 y	9 m	4 y	20 y				
	Scale 0 to 3	Days	Months						Scale 0 to 3	Months	Scale 0 to 3	
Austria	2.0	5.0	0.8	1.2	2.5	0.0	2.0	9.0	1.0	1.0	9.0	1.0
Belgium	1.0	3.0	2.0	3.6	11.4	0.0	0.0	0.0	0.0	3.3	12.5	0.0
Denmark	0.5	0.0	1.6	2.8	5.0	0.0	0.0	1.5	0.0	3.0	9.0	1.0
Finland	2.0	56.0	2.0	2.0	6.0	0.0	0.0	0.0	0.0	4.0	20.0	0.0
France	1.5	12.0	1.0	2.0	2.0	0.0	0.4	2.7	0.0	1.2	15.0	0.0
Germany	3.0	10.0	1.0	1.0	4.5	0.0	0.0	0.0	2.0	6.0	18.0	2.0
Greece	2.0	1.0	0.6	1.7	9.0	0.3	0.9	4.6	1.0	2.0	9.0	2.0
Ireland	1.5	3.0	0.2	0.5	2.0	0.0	0.5	3.9	0.0	12.0	24.0	1.0
Italy	1.5	0.0	0.3	1.1	2.2	0.7	3.5	18.0	0.0	0.8	32.5	3.0
Netherlands	3.0	35.0	0.6	1.0	5.3	0.0	0.0	0.0	1.0	2.0	5.3	1.0
Norway	1.5	3.0	1.0	2.0	5.0	0.0	0.0	0.0	2.0	1.0	15.0	2.0
Portugal	2.0	17.0	0.8	2.0	9.1	0.2	1.7	9.3	3.0	1.0	20.0	3.0
Spain	2.25	40.0	1.0	3.0	3.0	0.2	1.3	6.0	2.0	1.7	35.0	0.0
Sweden	2.0	7.0	1.0	4.0	6.0	0.0	0.0	0.0	1.0	6.0	32.0	0.0
Switzerland	0.5	1.0	1.0	2.0	3.0	0.0	0.0	0.0	0.0	3.0	3.0	0.0
UK	1.0	3.0	0.2	0.7	2.8	0.0	0.9	4.6	0.0	24.0	10.8	0.0
Argentina	0.0	15.0	1.0	1.0	2.0	1.0	2.0	10.0	0.0	3.0	20.0	0.0

Notes: (i) the variables tabulated under each key are as follows:

Procedures: procedures to be followed when issuing a regular dismissal notice; 1 for a statement in writing to the employee of reasons for dismissal, 2 for notification to a third party (works council or local employment exchange), and 3 when prior permission for dismissal must be obtained from a third party.

Delay to start of notice: the delay between a decision to dismiss and the time that notice can become effective after following required procedures in days (e.g. notification by registered letters assumed to involve 3 days).

Notice of period, 9m, 4y, 20y: the lapse between issuance of a dismissal notice and the effective cessation of employment, in months. The columns refer to workers who have been with the employer 9 months, 4 years, and 20 years respectively.

Severance pay, 9m, 4y, 20y: a lump-sum payment to the dismissed employee at the time of cessation of employment: the three columns differ as for the “notice period” above.

D= definition of unfair dismissal: scored 0 when worker capability or redundancy of the job are adequate grounds for dismissal, 1 when social considerations, age or job tenure must, when possible, influence the choice of which workers to dismiss, 2 when retraining to adapt the worker to different work must be attempted prior to dismissal, and 3 when worker capability can never be a basis for dismissal.

Trial period: the maximum length of the period after hiring during which an appeal against dismissal on grounds of unfairness cannot be made.

Compensation at 20y: the compensation payable to a worker who has been unfairly dismissed after 20 years with the employer.

Reinstatement: scored 0 if, following a court judgment of unfair dismissal, reinstatement is never granted, 1 if reinstatement is “rare”, 2 if reinstatement is “possible”, and 3 if the employee always has the option of reinstatement.

Source: Table 6.5, OECD Jobs Study, 1994. Argentina: the numbers are based on the 1974 Contract of employment law (20.744) as modified by law 21.297 and the 1991 National employment law (24.013) and laws 24.465 and 24.467 on contracts.

4.4. Benefit System and Active Labor Market Policies

The key features of the unemployment benefit system are the amount of benefit and the length of time for which the benefit is available. The Argentine system fits into the averagely generous but fixed term category although it is important to recognize that the coverage of the system is minimal (around 9 percent of the unemployed in 1997, see MTSS, 1996, 1997). This

arises because of the restrictive rules on entitlement (see Rodriguez Mancini, 1996). The requirements are strict but every unionized worker with some tenure would qualify. For that reason, the coverage was higher in 1993 than now. As the unemployment inflow has become more dominated by employees ending fix-term contracts and self-employees, the coverage of the system has been reduced to minimum levels.

5. The pathway of reforms

It would be a mistake to affirm that there have not been reforms in the Argentine labor market during the last decade. Indeed, there have never before been so many changes in the labor codes in Argentina as in the last decade. Many of the legislated changes, however, have been reverted during the same decade.

In our view, the main strategy adopted during this period to reduce wage pressure and discipline unions was the increase of product market competition through a wide program of trade liberalization. The openness of the economy still can be furthered and we believe it must be so.

Collective bargaining. This area is the one where less has been achieved during the decade. First, there has not been any attempt to modify the union structure by eliminating the prevalent single union system. This requires a change in the law of professional associations.

In terms of decentralization of collective bargaining, practically nothing has been accomplished. Nevertheless, in the last reform of 2000, some minor advances have been made although their impacts are still an open question. The parties of a negotiation are free to choose the level of bargaining and in the presence of conflict it is solved by a federal mediation agency. More importantly, it is established the prevalence of the firm agreements over the industry-wide agreements at any time. This is important because if there is a firm agreement in force and an industry-wide agreement is signed, the former prevail over the latter.

In addition, the law 25.250 of 2000 disposes the mandatory renegotiation of the collective agreements still in force signed in 1975. Interestingly, unions strongly oppose this reform and bargained that the contributions of the workers, both affiliated to the union or not but to whom

the agreement is extended, negotiated that the agreements of 1975 would remain in force in the renegotiated agreements.

Thus, this is an area where much still has to be done. The main objective would be to make operative again the collective bargaining system. The reform of 2000 goes in this direction but not much has been accomplished since it has been legislated. It must be clear that

Job security. Only minor changes have been introduced in job security across the board. The delay to start notice and the minimum severance payment of two months of salary have been eliminated. These changes reduce the cost of dismissing an employee with low tenure. Additionally, a trial period of three months with no severance payment has been legislated. The trial period has been legislated in 1995, restricted in 1998 and again reinstated with no tax advantages in 2000.

Contractual modes reforms. The severity of the unemployment problem in Argentina during the 1990s and the perception that reducing firing costs would help to reduce unemployment by enhancing labor market flexibility led the authorities to introduce changes in the labor legislation. Even though these were not major reforms, they introduced flexibility *at the margin* by creating fixed term and temporary contracts that eliminate or reduce dismissal costs but also reduced labor taxes for these contracts.

A first step toward reform took place at the end of 1991. Minor changes in the contract of employment law were introduced at that time. A very limited set of fixed term contracts and special training contracts for young workers were allowed. However, to utilize these new contracts in any sector of the economy, it was required the agreement of the respective industry union. This restriction was relaxed in 1994. In addition, there were other severe restrictions to make use of these contracts. Consequently, this reform did not have any impact in the economy. The monthly flow of new promoted contracts registered at the employment office (which was a requirement of these contracts) was below 5000 for the whole country.²⁷

The reform introduced the following contracts of employment:

1. Fixed term contracts to promote employment:

²⁷ That is, less than 0.05 percent of the labor force.

- Only applies to workers registered in the national employment office as unemployed or who were laid-off as a consequence of government employment cutbacks. This clause is very restrictive given that only a negligible proportion of the unemployed are registered as such in the national employment office.
 - Minimum duration: 6 months. Minimum renewal period: 6 months. Maximum total duration: 18 months.
 - Severance payment: Reduced fifty percent relative to an ordinary contract unless the contract is terminated before expiration where ordinary rules apply.
 - Reduction in labor taxes: employers' contributions were reduced from 33 percent to approximately 20 percent.
2. Fixed term contracts for new activity:
- Applies to new establishments or new lines of production or services.
 - Minimum duration: 6 months. Minimum renewal period: 6 months. Maximum total duration: 24 months.
 - Severance payment: same as above.
 - Reduction in labor taxes: same as above.
3. Promoted training contracts:
- Applies to workers less than 24 years old.
 - Duration varies from a minimum of 4 months to a maximum of 24 months.
 - Severance payment: none.
 - Labor taxes: Both employers' and employees' payroll taxes are eliminated.

At the beginning of 1995 the government passed a new reform that further developed the set of fixed term contracts available in the economy. This reform introduced a trial period for all contracts, special contracts to promote the employment of certain demographic groups and a special regime for small firms. In particular, these contracts did not require the approval of trade unions or a previous registration of any kind by part of the workers at any agency.

This reform introduced the following contracts of employment:

1. Trial period:
 - Applies to all new contracts.
 - Duration: 3 months.
 - Severance payment: none.
 - Reduction in labor taxes: Both employers and employees' mandated contributions to the social security system but their contributions to the health system (*obras sociales*) are excepted during the test period (the same applies to the worker's contributions).
2. Special promoted contracts:
 - Applies to workers older than 40 years.

- Minimum duration: 6 months. Minimum renewal period: 6 months. Maximum duration: 24 months.
 - Severance payment: none unless there is an early termination of contract.
 - Reduction in labor taxes: Employers' contributions to the social security system but their contributions to the health system are reduced fifty percent (the same applies to the employees' contributions).
3. Training contract:
- Similar to the training contracts legislated in 1991.
4. Small firms.
- The law establishes that small firms are also able to use the promoted contracts legislated in 1991 with the following additional advantages:
 - a. No previous approval of a trade union required.
 - b. Workers do not need to be registered in a government employment agency.
 - c. Severance payment does not apply.

It is worth mentioning that the incentives *at the margin* provided by the 1995 reform to use fixed term contracts were sizeable larger than those provided by the 1991 reform, both in terms of the reduction of the severance pay and in terms of labor tax cuts. This was particularly so in the case of the trial period legislated by the 1995 reform where there was no severance payment and the reduction of the labor taxes was the biggest of the whole set of promoted contracts. The impact of this reform is unambiguous and strong. Since 1995, almost all new employment positions fulfilled, at least in the formal sector of the economy, were under a trial period or a fixed term contract.²⁸

The reform of 1998 eliminates the promoted contracts regulated in 1991 and 1995 but the trial period was reduced to a month period. Later, in 2000, it was again extended to 3 months but the tax exemptions were eliminated.

²⁸ The new laws on fixed term contracts in 1991 and 1995 (see Martinez Vivot, 1996 and Sappia et al, 1996) have encouraged their use and by 1997 some 12 percent of employees were either on fixed term contracts (during which most of the social security contributions are reduced by fifty percent) or in the three months trial period of their contracts (during which time they can be laid off without severance pay and employers do not have to pay social security contributions). This compares with only 6 percent of employees in this category in December 1995, so the increase has been very rapid in recent years (see MTSS, 1996, 1997).

Payroll tax reductions. Employers' payroll taxes have been reduced. The reduction differed by region and only affected the employers' payroll contributions. For Buenos Aires, the employers' payroll contribution was reduced from 33 percent to 21.8 percent in 1999.

The pension system reform. In 1993, the government introduced a major reform to the pension system with the creation of private pension funds. The new legislation maintained the pay-as-you-go prevalent system while, at the same time, created a private pension option managed by pension funds, which was fully funded and based the retirement pension on the individual's contribution. Only the employees' contribution to the pension system is capitalized. The employers' contributions still finance the old system, which still has a distributive component for all workers

Workers' compensation insurance. It was changed in 1995. A workers' compensation insurance scheme in the event of a labor-related accident managed by private companies was adopted. Workers cannot litigate firms and the contingencies covered are now typified and regulated.

6. Conclusions

The balance of the pathways of reforms is mixed. Some important reforms have not been advanced while others have been achieved although its success necessitates further exploration. This is the mainly the case of the pension system reform.

The system of industrial relations in Argentina is broken. It does not work. There is no collective bargain at the industry-wide level and there are severe barriers to develop the bargaining at the firm or, at least, regional level. During the decade, there has only been a very timid attempt to decentralize collective bargain within the mark of the actual system of relations has been attempted. There has not been any attempt to modify the union structure by eliminating the prevalent single union system.

However, although it has not been the result of the formal bargaining, real wages have been very flexible during the period. This is a desirable property that needs to be maintained by any reform that is pursued in the future. One drawback of the wage flexibility observed during the 1990s is that it comes at the cost of very high levels of workers turnover. Nevertheless, there is an undeniable fact that comes out of this outcome: wage flexibility has been achieved at the firm level. It was not the result of collective bargaining responding to the crisis in the labor market. Thus, the decentralization of collective bargaining at the firm level may help to achieve wage flexibility and also to decrease the excess worker turnover that was necessary to achieve this level of wage flexibility. Additionally, as we discussed, the decentralization of collective bargaining would enhance efficiency and increase output and productivity growth.

The decentralization of collective bargaining in Chile was one of the great successes of the structural reforms in this country. Unions' power was severely decreased and bargaining was decentralized at the firm level in 1980. Edwards and Edwards (2000) present evidence showing that this reform was central in reducing equilibrium unemployment in Chile.

Thus, it is clear that the modernization of the system of industrial relations in Argentina is still pending. At the minimum, the actual system shall be induced to facilitate the decentralization of collective bargaining. It has to be noted that major reforms may not be easy to achieve in this area. The reform of the health insurance system is intimately related to the working of the system and may be a place to start. During the 1990s there has been some attempts to reform it and some advances have been achieved. Workers now can choose their insurance among those provided by unions. Thus, a certain level of competence has been introduced in the system but a deeper reform is still pending.

The reforms to job security across the board have been in the right direction. A trial period of 3 months has been legislated in which there is no severance payment or notice period. It may be extended by collective agreement to 6 months. The cost of dismissing a worker during his or her first year of tenure has been reduced by eliminating the requirement of a severance payment of two months. Finally, the delay to start notice has been eliminated. However, the severance pay system is still quite generous. However, all the evidence suggests that its impact on unemployment is minor although it affects its distribution (see Heckman and Pagés-Serra, 2000).

As we already discussed, if employment protection is to be reduced, it is much better to reduce severance pay across the board than to create a separate class of workers on fixed term

contracts, as was the case in Argentina. Additionally, a severe pitfall in the design of the fixed term contracts in Argentina was that its use was incentivated by adding to them huge payroll taxes excerpptions. This exacerbated turnover rates (see Galiani and Hopenhayn, 2000 and Hopenhayn, 2000). Thus, we believe there are good arguments against relying on the fixed term contract route to flexibility. This is not to say that the Argentine labor market does not need to be highly flexible. *But the key is to focus on wage flexibility, not on employment flexibility* except in so far as it enhances wage flexibility.

As a general principle, it is a good idea to reduce labor taxes if at some point it is fiscally prudent to do so. In general, there is no need to concentrate on payroll taxes (*except perhaps for the very low paid*), cutting any labor taxes will do. Notwithstanding, in disequilibria, where the actual unemployment is well above the equilibrium unemployment rate, a reduction in payroll taxes may have a greater impact on employment than the one it would have in equilibrium. Pessino (2001) suggest that this was the case in Argentina.

To conclude, it is worth to note that the actual levels of unemployment are likely to be well above the equilibrium level of unemployment. Thus, reforms to labor market institutions are not the sole route to reduce unemployment. Restoring growth is central to reduce unemployment and to recover wage growth. *Thus, the priority of the economic policy should be to restore growth.* We believe that the main concern should be focused on how to restore a sustainable process of economic growth. The boom and bust cycles that the economy experienced during the second part of the 1990s are very harmful for employment. Firms are more likely to increase employment when they forecast sustained growth than when they expect a transitory demand positive shock, especially when firing cost are elevated like it is the case in Argentina.

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