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Evidence from Brazil on the Enforcement of Labor Regulations and the Effects of Trade on Labor Markets

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Introduction

In this research, we look at how co-ethnic networks influence immigrants' economic performance. We find that immigrants in districts with greater co-ethnic networks are more likely to be employed soon after arrival, using longitudinal data from Germany and a wide set of fixed effects and pre-migration controls to address the possible endogen etic of initial location. After four years, this advantage decreases as migrants in regions with smaller co-ethnic networks catch up due to higher human capital investments. Lower-skilled immigrants, as well as refugees and ethnic Germans, appear to be more affected.

Informality, on the other hand, brings with it more de facto labor market flexibility, which can be especially useful in the face of onerous and stringent labor legislation. In comparison to a counterfactual scenario with perfect enforcement and no informality, greater flexibility may help enterprises and people deal better with unfavorable economic shocks, perhaps reducing job losses. This hypothesis has significant implications for how one analyses trade-induced labor market impacts and their possible welfare repercussions. More broadly, it means that the rigidity imposed by labor market restrictions can wreak havoc on the labor market and aggravate job losses caused by severe economic shocks. This last point refers to a large body of literature that examines the effects of labor rules and labor market rigidity on workers.

This paper addresses these challenges by drawing on Brazil's unilateral, large-scale trade liberalization in the early 1990s. For at least three reasons, Brazil is an appealing empirical site. To begin with, unilateral trade liberalization had significant and disparate consequences on local labor markets. Second, in 1988, just prior to the start of the trade liberalization process, Brazil underwent a major constitutional revision that significantly increased the restrictiveness and direct costs of labor regulation. Third, labor legislation enforcement differs widely throughout Brazil's regions. We use spatial heterogeneity in the severity of trade shocks and labor regulation enforcement to see if, and to what degree, the presence of a more costly regulatory framework modifies labor market reactions to trade liberalization. More broadly, we look at whether increased de facto labor market flexibility (as a result of informality) leads to less job losses in the event of a negative economic shock.

To answer these problems, we create a measure of local trade-induced shocks based on changes in tariffs at the industry level and the initial sectorial composition of employment across regions, which remains constant at the levels seen prior to the trade opening process. The (conditioned) erogeneity of these trade shocks in relation to (unobserved) pre-existing trends in local labor markets is a crucial identification assumption. Previous studies that have used the same regional trade shock have found direct evidence to support this hypothesis. The measuring of enforcement capacity and intensity across local economies is a second important part of our empirical technique. In Brazil, the ministry of labor is solely responsible for enforcing labor regulations, and the technology used to do so is relatively simple: Labor inspectors are assigned to Labor Offices (LOs) situated throughout the country, and they go by car to check businesses. As a result, enterprises that are further away from LOs are less likely to be examined, and enforcement is more likely to be lax (all things equal). As a result, we utilize the distance to the nearest labor office as a proxy for a market's enforcement capacity. We collect new data on the dates of establishment of all labor offices in Brazil and limit our study to those established prior to the start of the trade opening process. As a result, our measure of enforcement capability is pre-determined in terms of future trade shocks and labor market conditions in the local area.

Labor Regulations and Enforcement

To begin, we look at the fundamental consequences of regional trade shocks on labor market outcomes. We compute local labor market outcomes without the influence of socio-demographic variables using individual-level Census data from 1991 to 2000. Our findings back up prior research, showing that between 1991 and 2000, places more exposed to the trade liberalization shock saw a significant increase in both informality and non-employment compared to those less affected. The investigation of these impacts across ability levels, which yields startling results, is what makes this study unique. Low-skill employees are responsible for nearly all of the negative effects on informality, unemployment, and wages. High-skill workers have no informality effects and have significantly lower and marginally significant non-employment and wage effects.

We use administrative data from the Ministry of Labor to supplement the Demographic Census results by containing the universe of formal enterprises and workers. In comparison to regions with greater enforcement capacity, we find that regions with poorer enforcement experience a bigger decline in formal employment. This suggests that, in addition to job preservation, there is a ‘switching effect' from formal to informal jobs in hard-hit areas with lax enforcement. We show, however, that the increased flexibility offered by lower enforcement also leads to improved formal establishment survival, as regions with weaker enforcement capacity have fewer formal plant losses. This finding is in line with the fact that a significant portion of informal employment is found in formal businesses, a phenomenon known as the "intensive margin of informality." Furthermore, research suggests that the intense margin is critical to formal enterprises' survival in the face of a negative economic shock.

Trade Liberalisation and Local Trade Shocks in Brazil

The danger to identification would thus have to come from some undisclosed, time-varying regional characteristic that affects labor market results within a particular state, is not captured by local economies' starting socio-demographic characteristics, and is also linked to the placement of labor offices. Our results are resilient to a range of additional potential confounders; therefore this is unlikely to be the case, according to the detailed robustness study in subsection. We begin by looking into whether our findings are influenced by reversion to the mean across regions with varying levels of informality and non-employment at the outset. This would be the case if our enforcement capacity metric, rather than enforcement capacity per second, was reflecting variability in baseline informality levels. This is not the case, as the results remain unchanged when informality and non-employment rates from the 1980s are included. We also look into whether our findings account for the aforementioned "remoteness effect." We do so by considering the state's median driving distance, which allows for differences in trends based on closeness to the capital, while the results stay unchanged (if anything, they become stronger). Finally, we take into account per capita spending by local governments and the Gini coefficient, both of which were measured in 1991. The former is designed to account for the likelihood that the distance to the labor office is a proxy for the availability of local public goods and infrastructure in general, rather than the enforcement capacity per second.