

MERCOSUR and the Uruguayan Labor Market: Increase in vulnerability may outweigh gains from integration

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Uruguay is a small economy, vulnerable to external shocks. Its entry into MERCOSUR has increased exposure to regional macroeconomic instability and has also affected the unskilled labour market, raising informality and unemployment. The wage gap between skilled and unskilled, and formal and informal labour has increased. Indeed, a team of Uruguayan researchers funded by the PEP network has estimated a wage gap of 60 percent between formal and informal workers.

This team went on to simulate the impact of regional integration and other macroeconomic shocks on the country's labour market and poverty using a CGE model and microsimulation analysis. The CGE model is conventional except that formal sector unskilled workers are assumed to receive a wage premium in order to avoid shirking or because of training costs (efficiency wage specification). If a formal worker is fired, s/he moves to the low productivity informal sector.

The main findings are:

Changes in the share of the main partners in total trade have different impacts on the labour market. If exports to Argentina increase, demand for unskilled labour decreases and informality increases. The opposite happens when exports to Brazil increase.

Given regional macroeconomic instability, negative external shocks from MERCOSUR partners have had a stronger impact than any change in tariffs that are currently being negotiated with regional partners. As long as regional instability persists, Uruguay should be cautious with trade integration policies and try to avoid an excessive regional dependency.

It is important to take into account the existence of imperfections in the labour market. The effects of external shocks are clearly different when we assume "efficiency wages" in the unskilled formal labour. In this case, when the economy specializes in unskilled labour

intensive sectors, there is an efficiency loss. This result underscores the need to make an appropriate analysis of the labour market.

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