"Labour and Product Market Reforms: Questioning Policy Complementarity"

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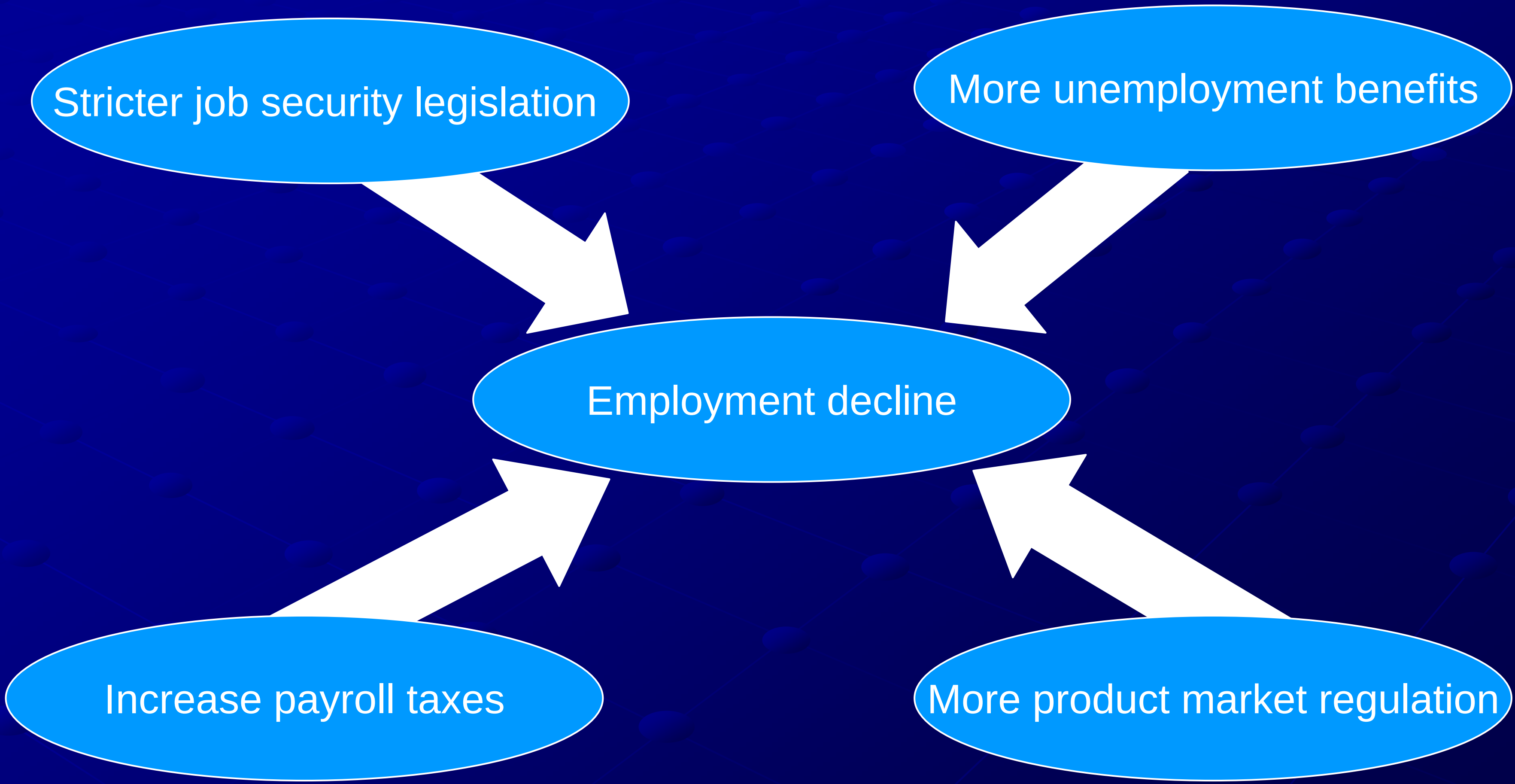
Labour and product market reforms: Questioning policy complementarity

1. Standard model of PMR and LMR
2. Model with ‘perverse’ effects
3. Complementarity in the standard model
4. Not necessarily so in ‘perverse’ model
5. Empirical question
6. Some empirical evidence
7. Conclusions

1. Standard model of product and labour market reforms



2. Model with ‘perverse’ effects

- **Product market reforms (standard model)**
  - Increased competition
  - Lower price and wage mark-ups
  - Employment gains
- **Product market reforms (perverse model)**
  - Increased competition with wage rigidities
  - Increased hiring and firing
  - Adverse effects on incentives to work
  - Wage pressure
  - Employment losses

3. Complementarities in the standard model

Σ(Employment gains from individual reforms) < Employment gains from set of reforms

- Economic arguments
  - More flexible product markets permit to better extract the benefits of labour market reforms (and reverse)

Σ(Acceptability of individual reforms) < Acceptability of set of reforms

- Political arguments
  - Reduce political opposition by compensating losses associated with one reform by gains associated with another

4. Not necessarily so in ‘perverse’ model

Σ (Employment gains or losses from individual reforms) > or < Employment gains from set of reforms

Not very surprising if perverse effects

Key questions no longer theoretical but empirical
Are perverse effects common?
If so, are reforms complementary?

5. Empirical question

"…*European countries engaged in large-scale deregulating reforms have not experienced, as it was expected, substantial increases in aggregate employment levels*"

Quote of last sentence in paper

If true, this could be viewed as evidence that:

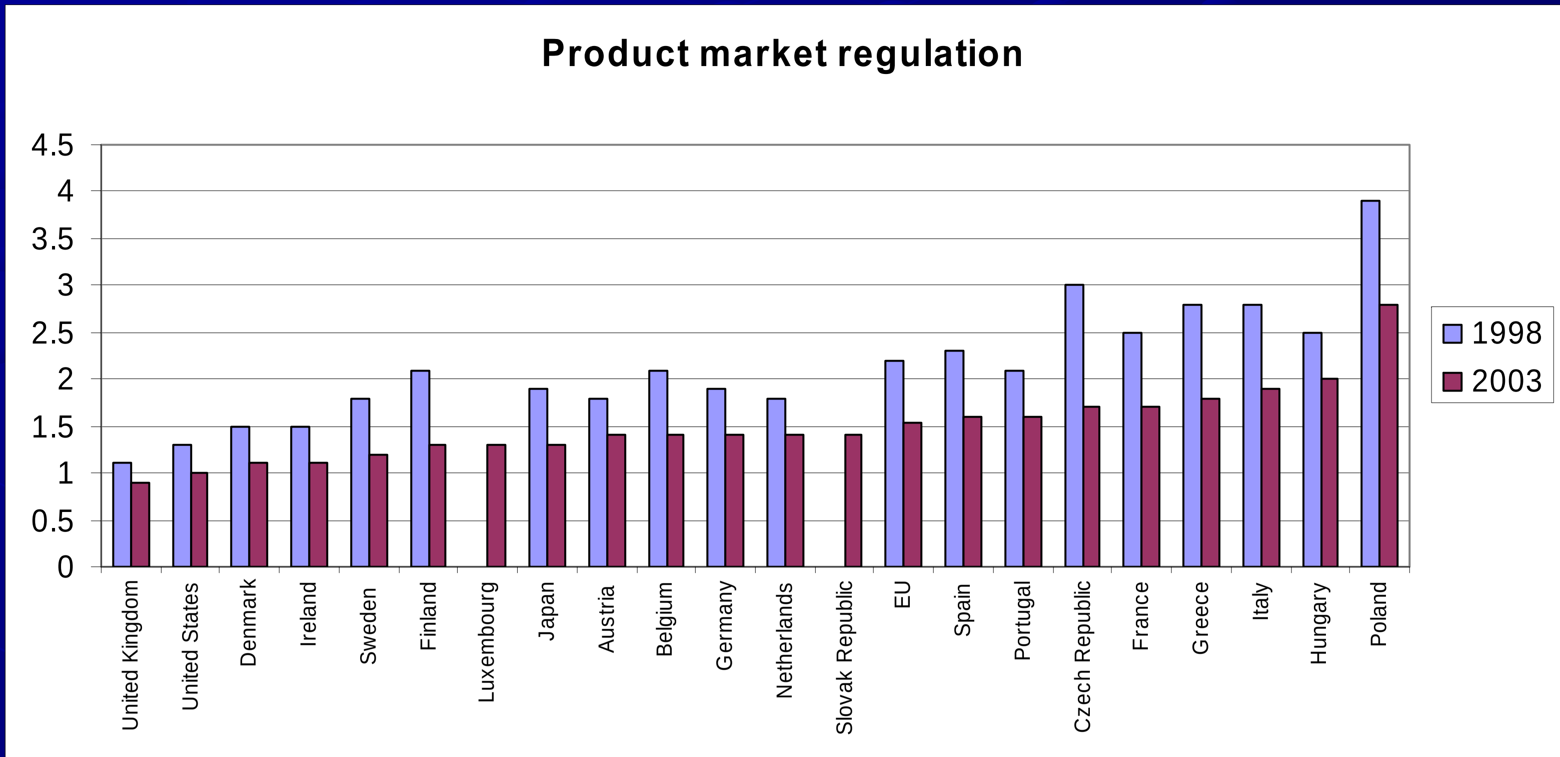
- ☞ Some reforms negatively affect job creation
- ☞ Reforms are not mutually reinforcing

6. Some empirical evidence

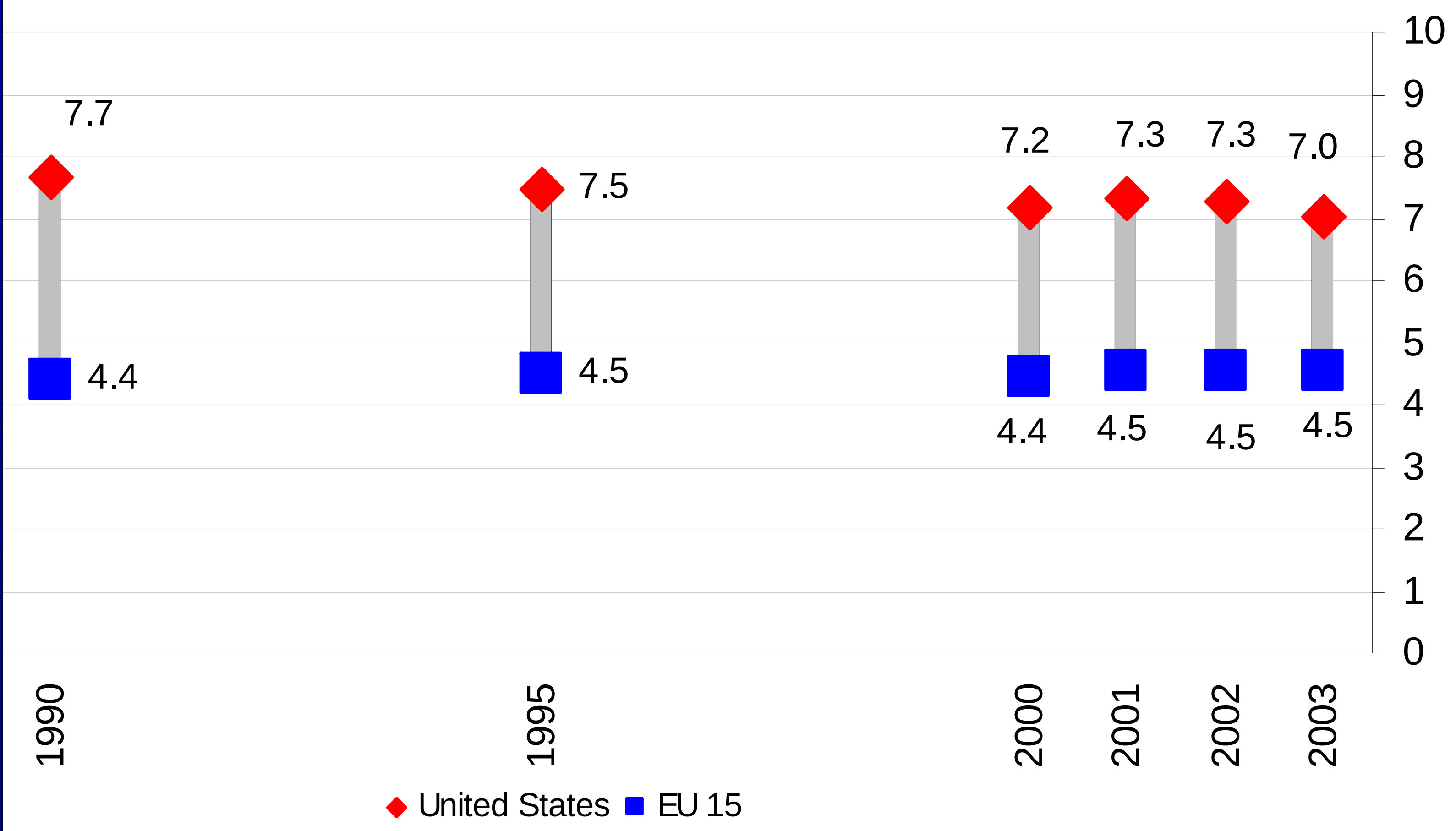
1. OECD product market regulation database
   - Barriers to entrepreneurship
   - Barriers to trade and investment
   - State control

2. Fraser index of labour market regulation
   - Impact of minimum wage
   - Hiring and firing practices
   - Share of labour force whose wages are set by centralised collective bargaining
   - Unemployment benefits
   - Use of conscripts to obtain military personnel

ad 1) OECD product market regulation in 1998 and 2003



ad 2) Fraser index of labour market regulation

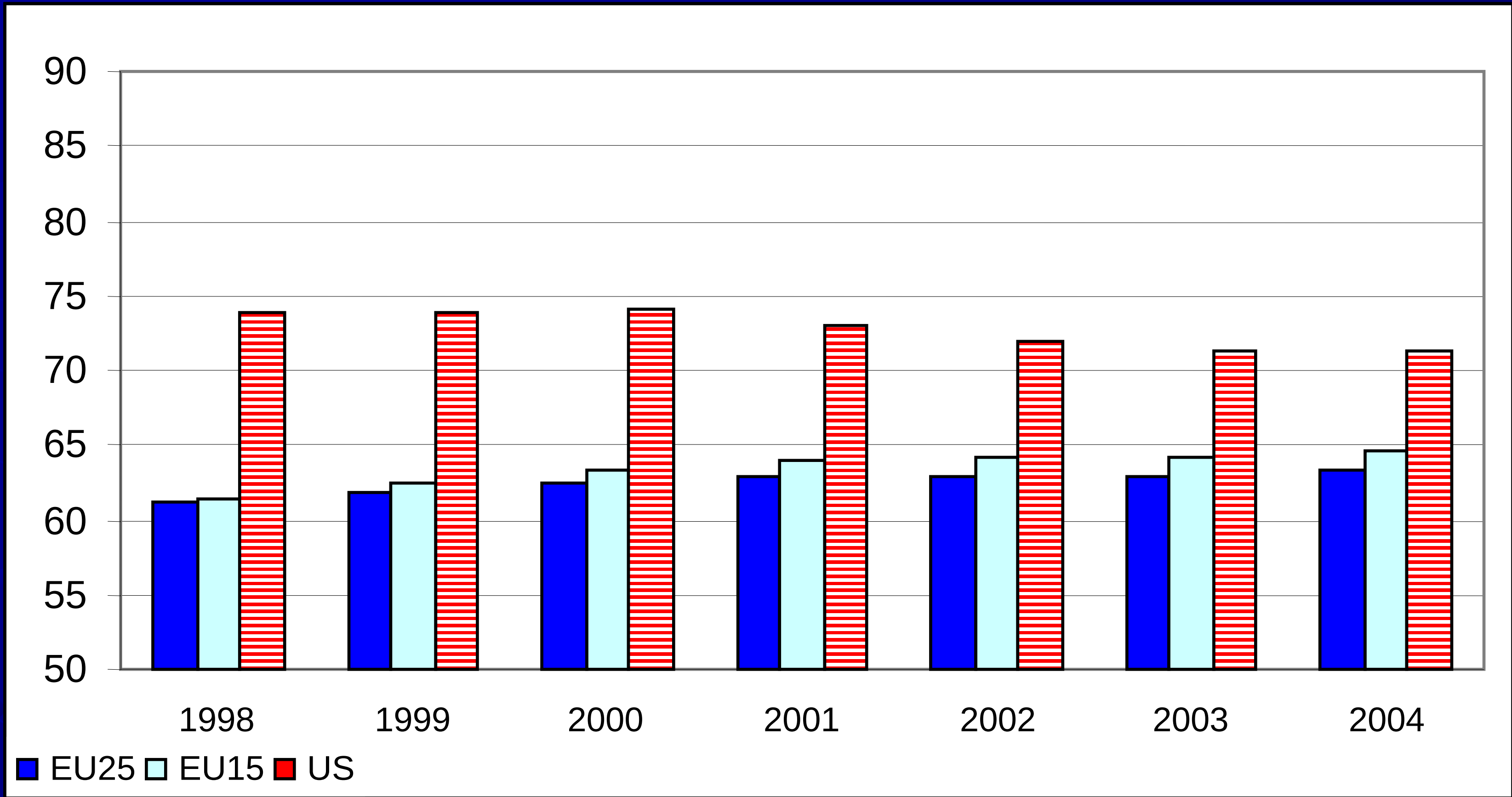


Source: The Fraser Institute –Economic Freedom of the World: Annual Report 2005

Score 10 = unregulated; Score 0 = totally regulated

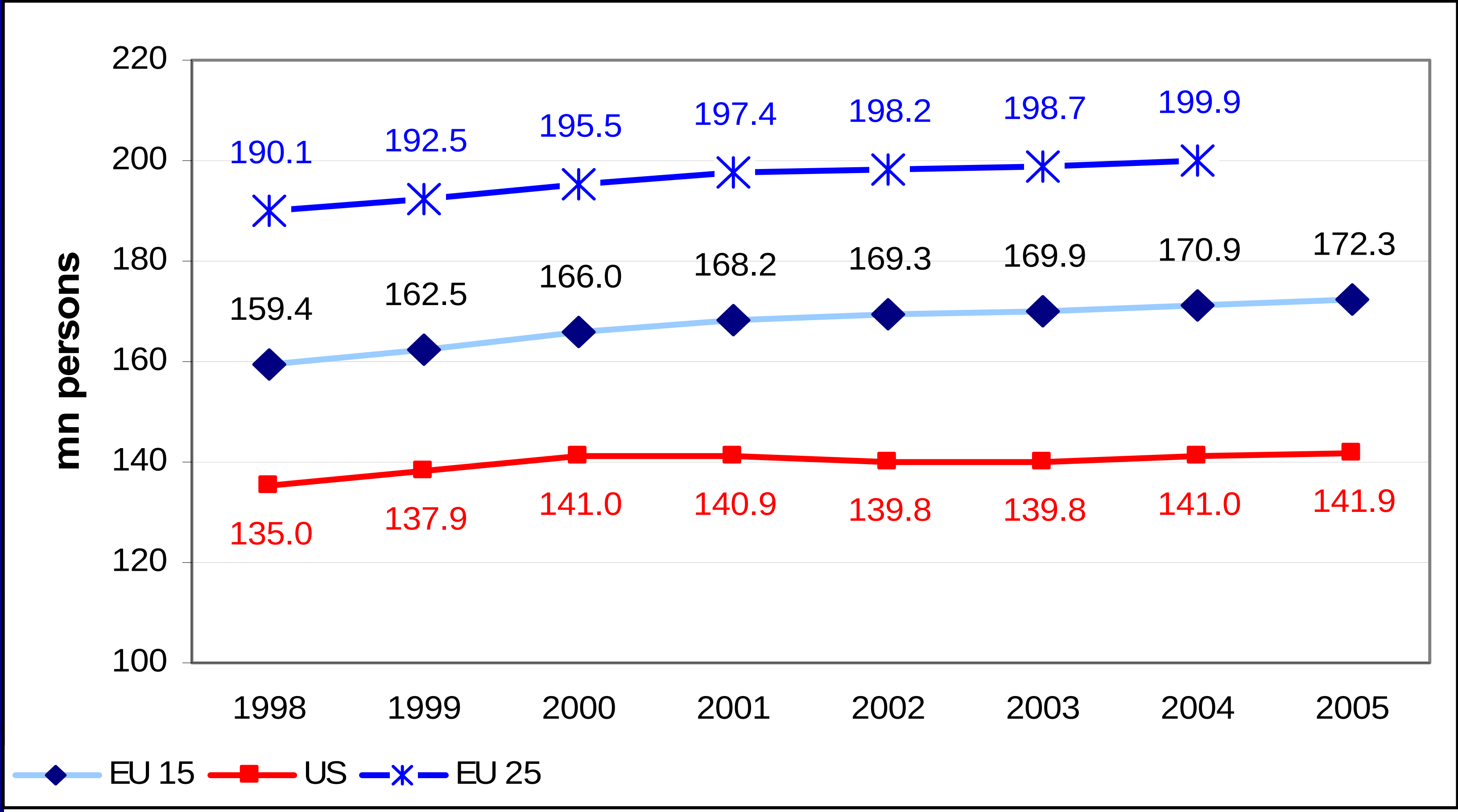
EU15: unweighted average of country scores

Employment rate in EU 25, EU15, US



Source: EUROSTAT Structural Indicators
Total employment rate - Employed persons aged 15-64 as a share of the total population of the same age group

Employment in EU 25, EU15, US



Source: EUROSTAT Annual National Accounts
Total employment – national concept - Employed persons aged 15-64 as a share of the total population of the same age group

Conclusions

In theory:

- Reforms can have negative effects on job creation and growth
- Reforms need not to be mutually reinforcing

Continued collection of empirical evidence on benefits of reform is essential:

1. EU-wide evidence shows more progress with product market reforms than with labour market reforms, but
2. Aggregate figures may hide true picture