Discussion of “Labour and product market reforms: questioning policy complementarity”

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Outline

• Brief comments on model (not my CA)

• Comparison of implications with evidence
  – Difficult to comment on preliminary evidence presented in A-G slides

A plea to begin: please do not caricature OECD positions on labour market reform!
Non-technical comments on the model by a profane

• **Is the efficiency-wage model relevant for describing bargaining in a regulated economy?**
  – Bargaining is likely to be endogenous to rents (see Ebell and Haefke), hence efficient bargaining or right to manage may be more appropriate especially for EU countries

• **Is hiring and firing regulation usefully described?**
  – In your model, F has no effect on labour cost (fully shifted to lower real wages) → no wonder that F increases employment
  – However, real world problem is not with level of redundancy payments but with uncertainty about their actual cost

• **Is job security the right concept?**
  – Not clear how the model deals dynamically with employment security in more competitive/flexible markets
  – Risk of job loss vs cost of job loss

• **Is the specification of competitive pressures adequate?**
  – Modeled as increased rivalry among existing firms (elasticity of substitution) → but Blanchard-Giavazzi and Ebell-Haefke show employment gains in this case are small
  – To get larger effects you need to model fixed entry costs and new firm entry
Comparing assumptions, implications and evidence (1)

- Large PMR reforms and little LMR reforms in many OECD countries so far. Even so, employment gains were significant in several countries

- Rising evidence that PM liberalisation may increase long-run employment and decrease unemployment
  - Boeri et al., Nicoletti-Scarpetta, Bassanini-Duval, Messina, Pissarides, Griffith et al., Bertrand-Kramarz, Ebell-Haefke (simulations)

- Some weak cross-country evidence that PM liberalisation increases risk of job loss but decreases cost of job loss
  - Nicoletti et al. (2001), but time-series evidence needed

- Conflicting and/or weak evidence of effect of EPL on employment/unemployment…

- …but evidence of negative effect of broader LMR measures on employment/unemployment…

- …and evidence that EPL lengthens unemployment spells (in contrast to A-G’s proposition 2)
Comparing assumptions, implications and evidence (2)

Little empirical work on complementarity/substitutability

• Bassanini-Duval (2006 forthcoming) find

\[
\frac{\partial U}{\partial EPL} = 0, \quad \frac{\partial U}{\partial PMR} > 0, \quad \frac{\partial^2 U}{\partial EPL \partial PMR} > 0
\]

in model with multiple interactions

➢ Strong complementarity?

• Nicoletti-Scarpetta (OECD ECO WP 472, 2005) find

\[
\frac{\partial L}{\partial LMR} < 0, \quad \frac{\partial L}{\partial PMR} < 0, \quad \frac{\partial^2 L}{\partial PMR \partial (High \ LMR)} < 0, \quad \frac{\partial^2 L}{\partial PMR \partial (Low \ LMR)} = 0
\]

in model with principal components

➢ Same result found for interaction of PMR with LMR and bargaining institutions

➢ But interpretation differs from A-G substitutability (Ebell-Haefke)
Comparing assumptions, implications and evidence (3)

- **Political economy considerations:**
  - If A-G right then we should see PM liberalisation followed by EPL tightening
  - But in fact OECD anecdotical evidence and new empirical results strongly suggest that PM liberalisation is followed by loosening of EPL … for temporary contracts
  - This has helped generating employment, but also dual labour markets
  - And contrary to common sense arguments has not led to loosening of EPL for permanent contracts
Conclusion
(admittedly partially...

- A-G idea is neat...
- ...but the model assumptions are not a convincing depiction of reality...
- ...and the empirical implications seem to be at variance with available evidence
- However, analysis has advantage of injecting some doubts on mainstream views and calling for more empirical analysis for sound policy packaging
Reforms in labour and product markets (1985-2003)
Figure 4. Liberalisation of product market over 1992-1999 and reforms in labour market over 1997-2004 (absolute change)

Coefficient: 0.13  t-statistics: 1.54*

Note: Both restrictiveness indicators of labour and product markets are normalised, ranging from 0 to 1.
Source: OECD