EMU and Labor Market Policy: Tensions and Solutions

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Labor policy almost completely subsidiary in EU.

Reasons:

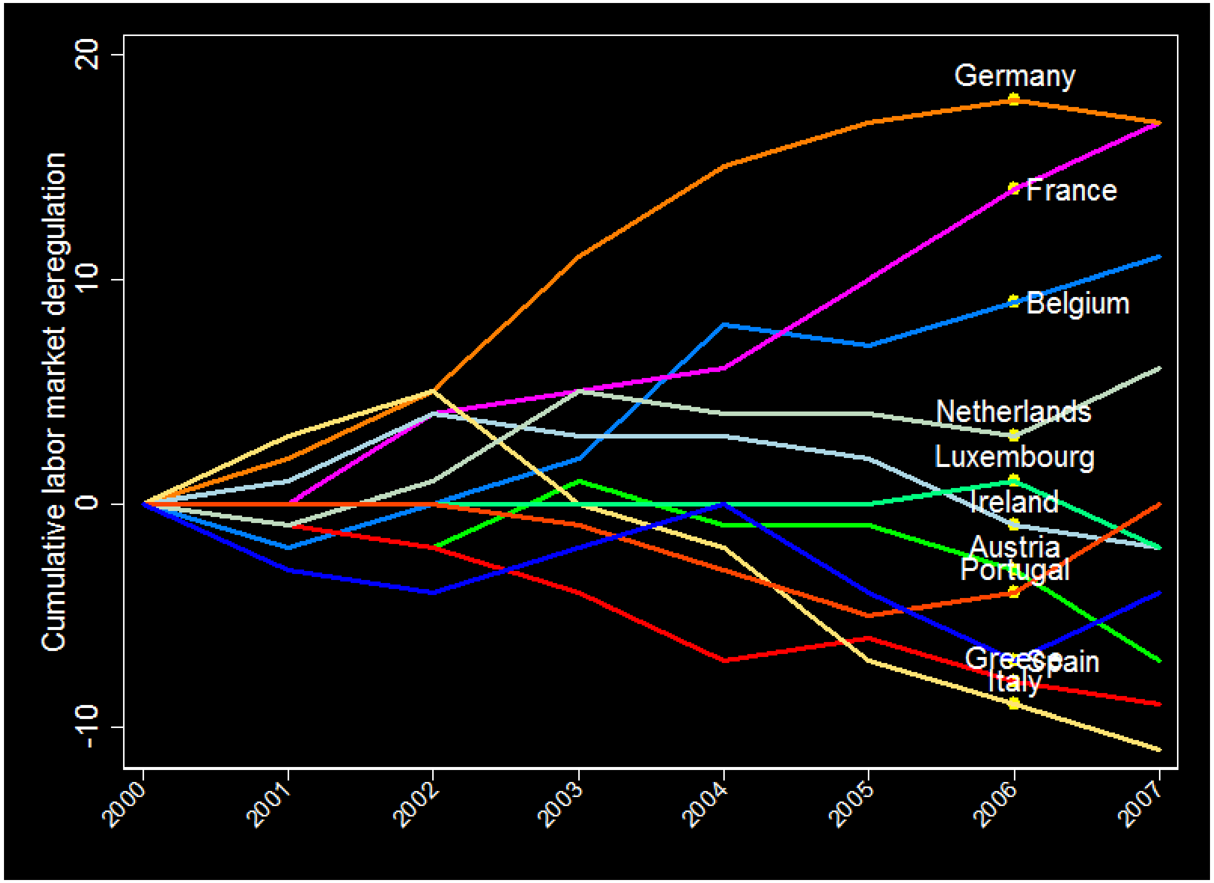
1. Technical: local conditions and traditions differ very much; spillovers less problematic than coordination.
2. Political: need difficult compromises between contrasting interests; the only suitable political processes are National in Europe.

Labor policies do change:

Causes, consequences?

Drift or come together?

LABREF labor market reforms cumulative count.

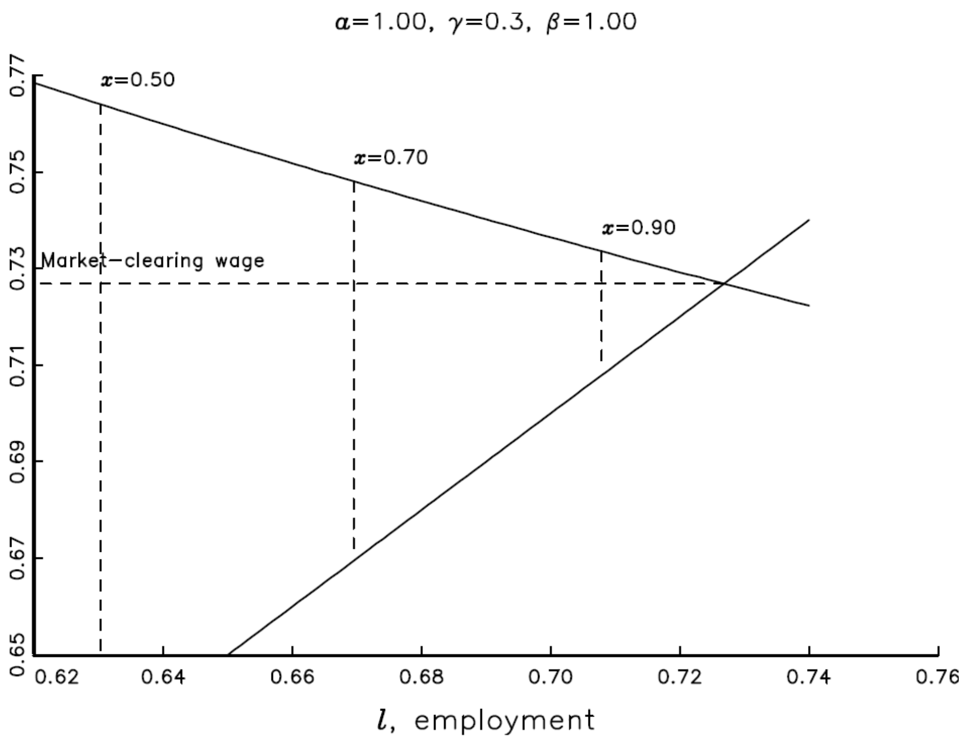


After EMU,
Before crisis:
some countries deregulate,

some regulate **labor markets.**

Not just a race to the bottom (and not convergence, in other level data)

Labor policies:

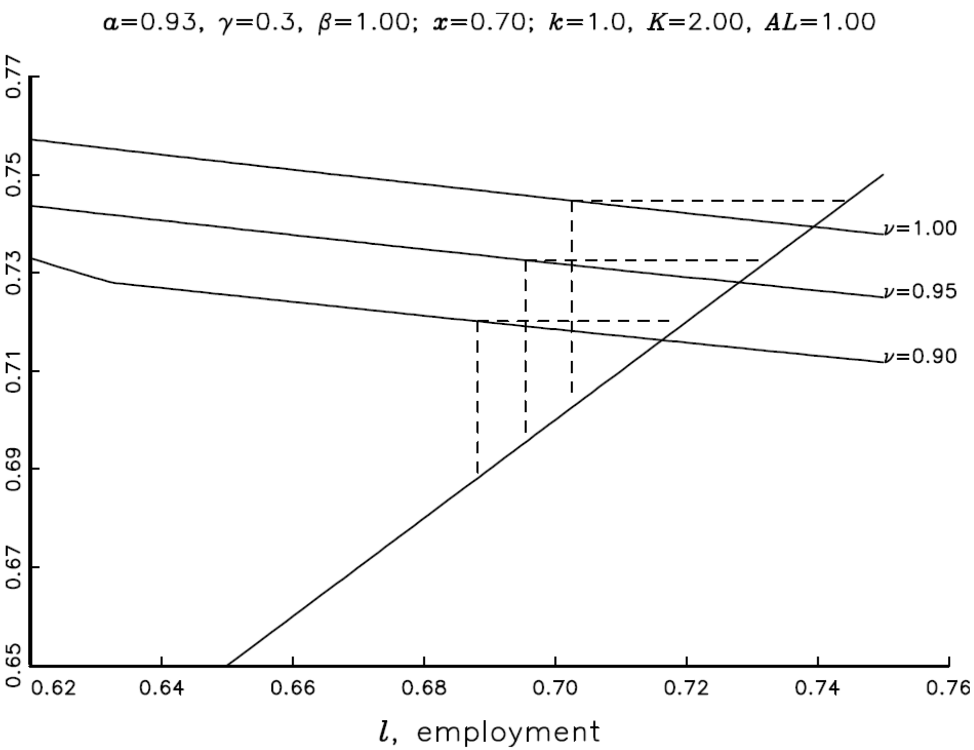


If politically decisive agent owns $x<1$ fraction of per-capita wealth, reduce employment (labor taxes and non-employment subsidies, legal or collectively bargained minimum wages, working time limits)

Because: for capital-poor individual, higher labor income offsets lower non-labor income.

Inefficient from representative-agent perspective, but democratic outcome if imperfect compensatory transfers.

International financial integration:



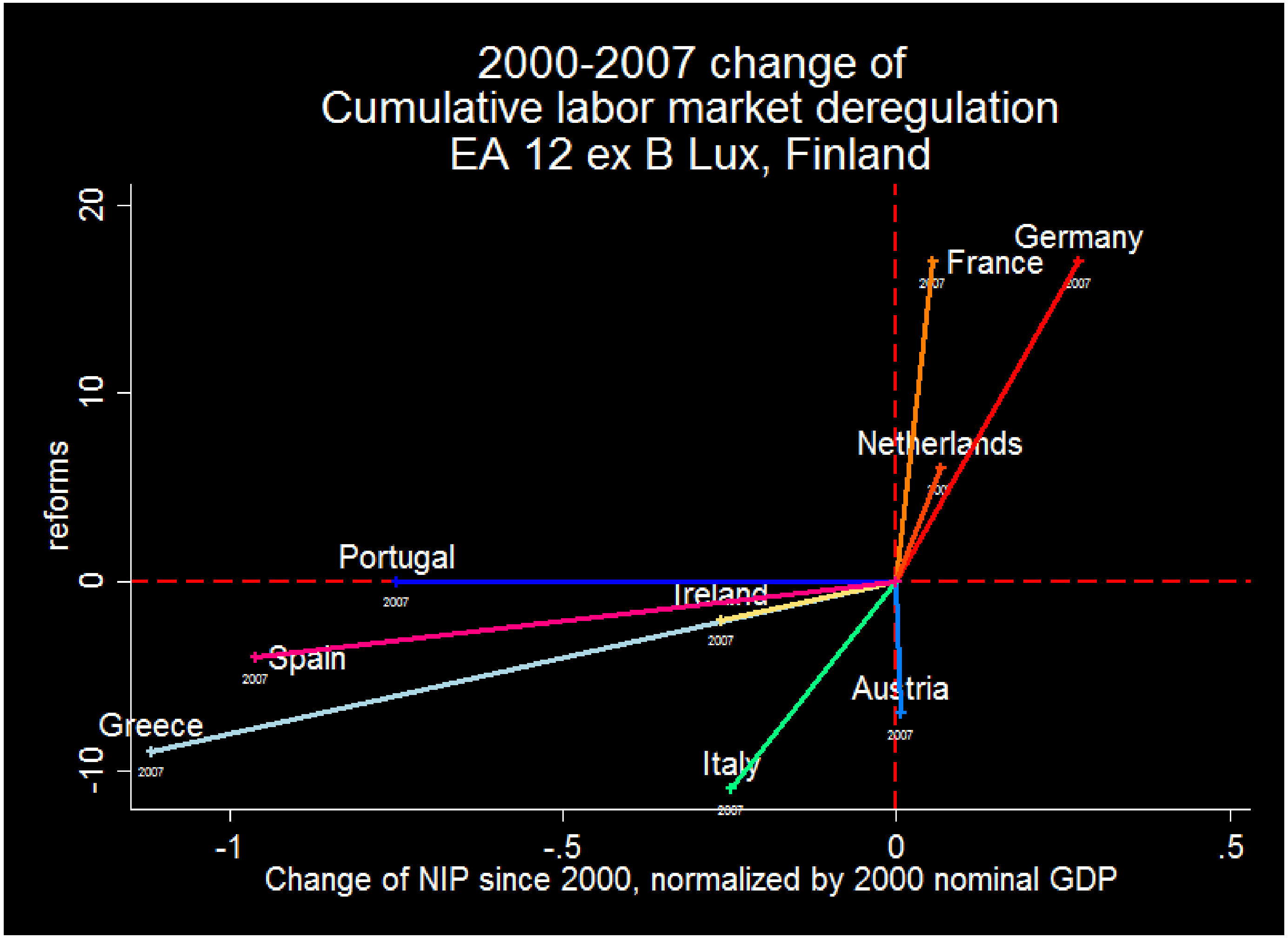
ν index of foreign-owned capital productivity:

As ν↗1,
capital inflows increase labor demand
but (given x) stronger employment-reducing policies.

Because: national decisive agent does not care about foreign capital income,
higher productivity strengthens the integrated-area impact of the country's policy.

Early EMU: exploding apart

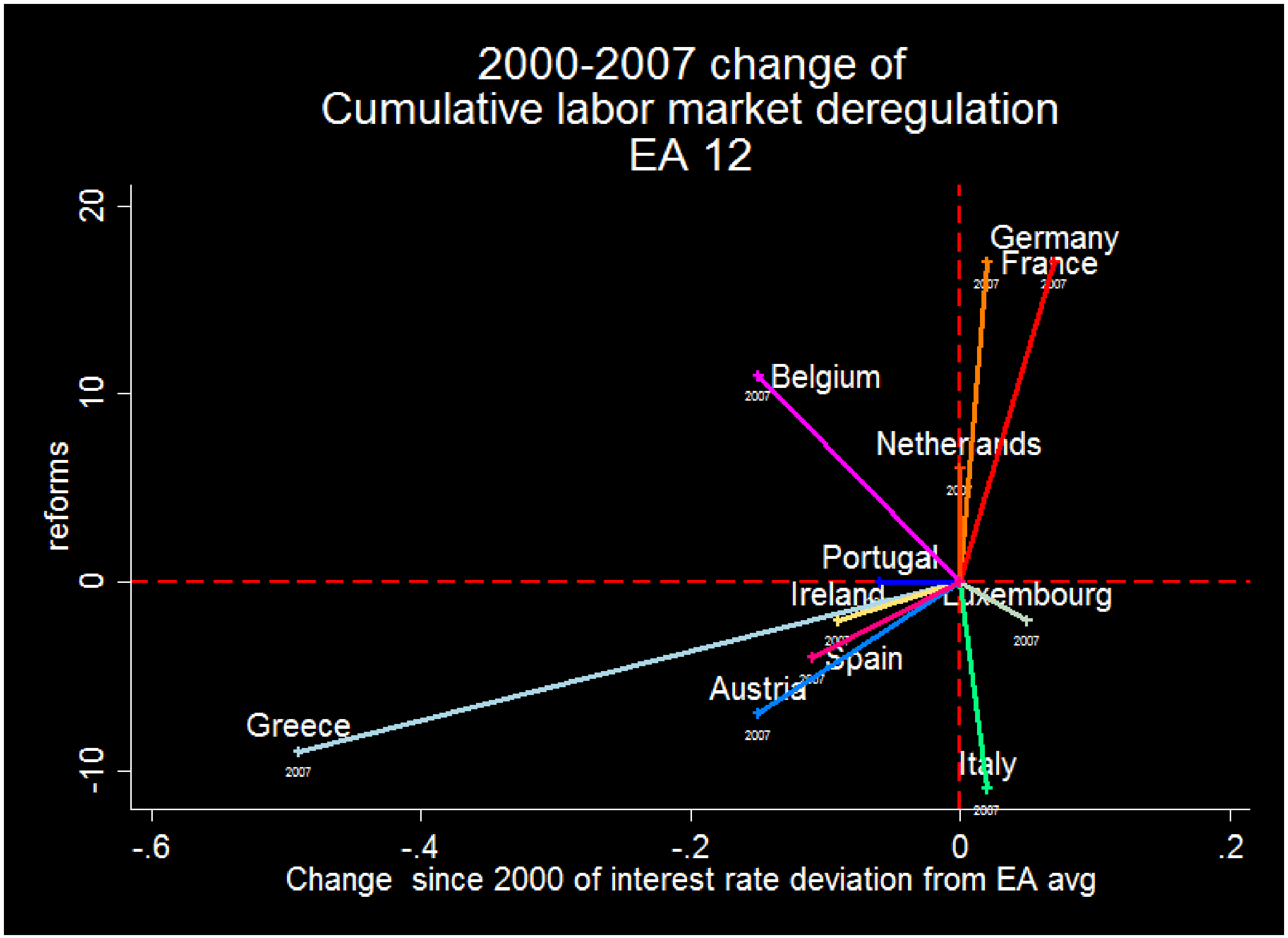
labor market deregulation



International imbalances

Early EMU: exploding apart

labor market deregulation



Interest rate convergence

Early EMU: exploding apart

For sensible theoretical reasons:

Both imbalances and labor market policy divergence are natural endogenous consequences of financial integration with policy subsidiarity.

Labor market reforms

- Stabilize macroeconomic imbalances,
- Compound the distributional implications of international integration:

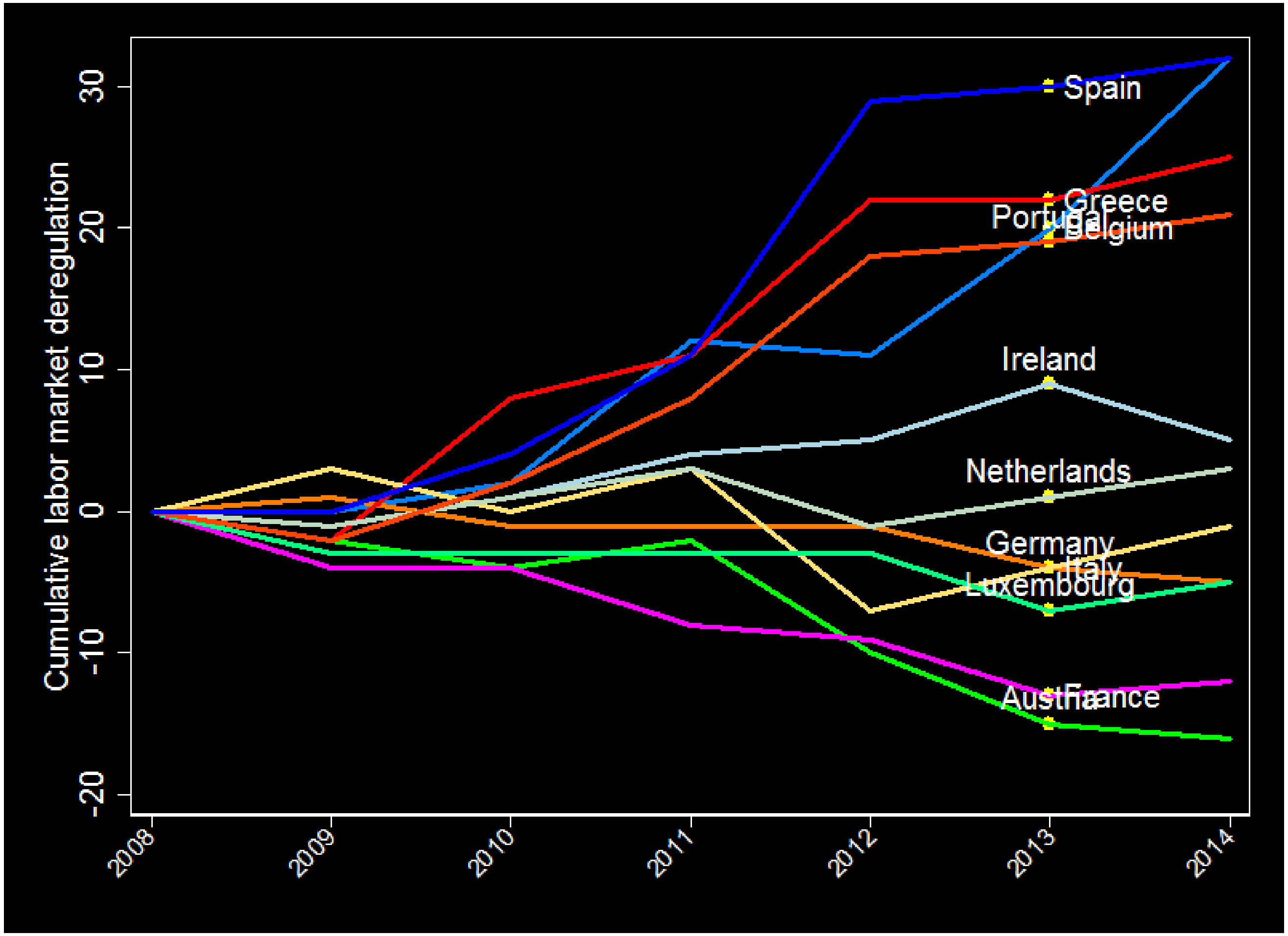
Worker majority gains in capital-inflow countries,

loses in capital-outflow countries.

Political problems possible…

…**Crisis:** reverse labor reforms

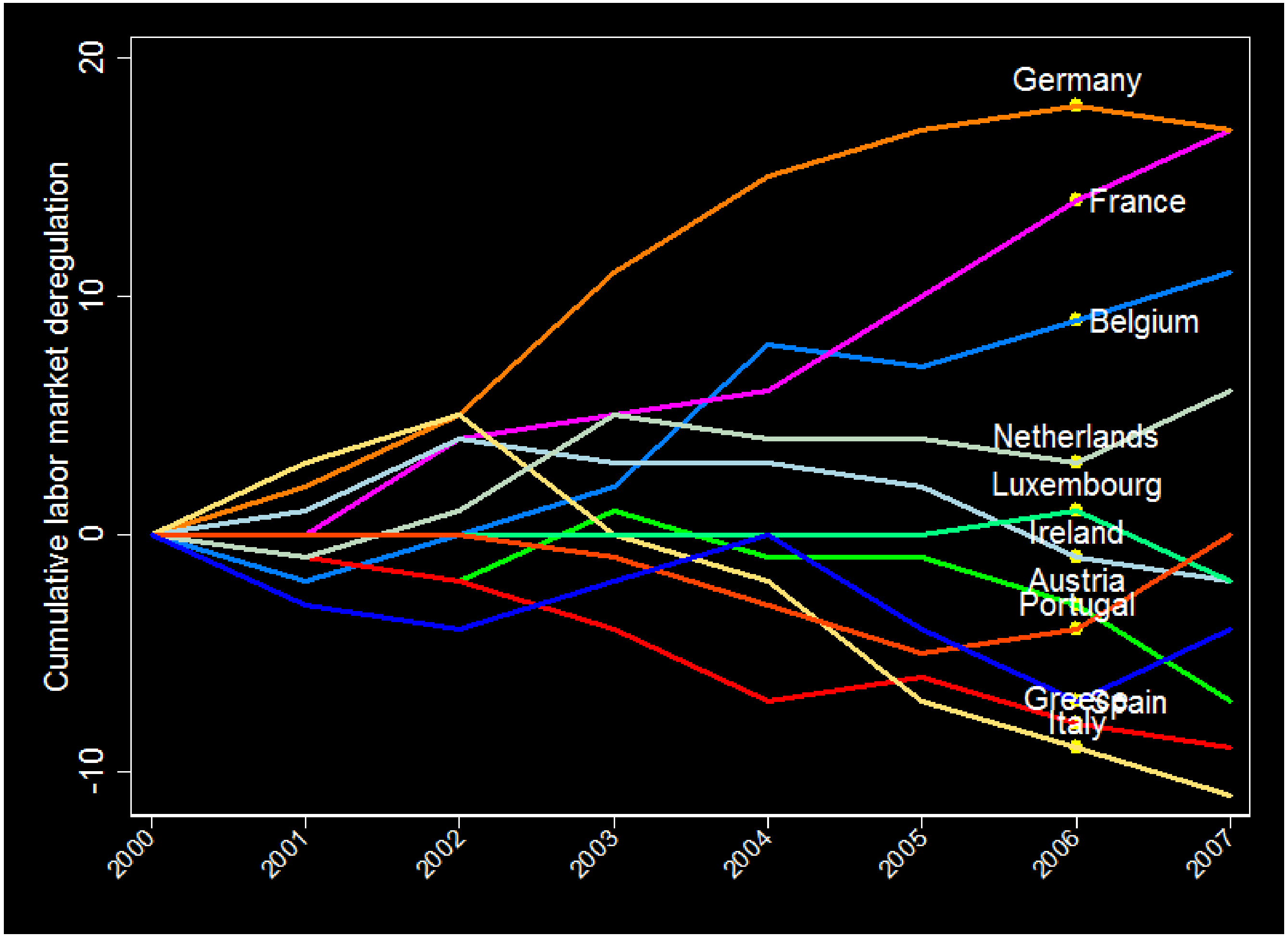
labor market deregulation



Other countries deregulate,

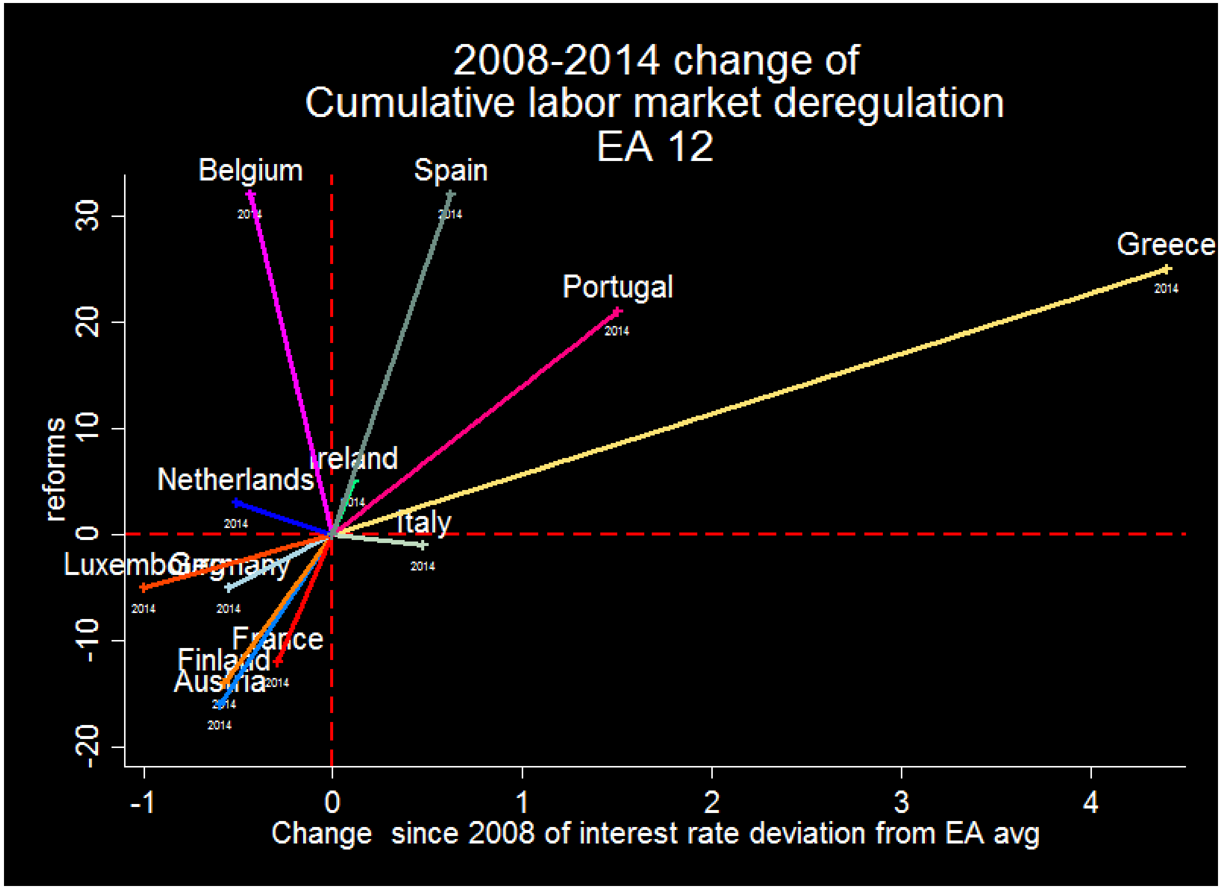
Other regulate **labor markets.**

(before crisis)



Crisis: financial disintegration…

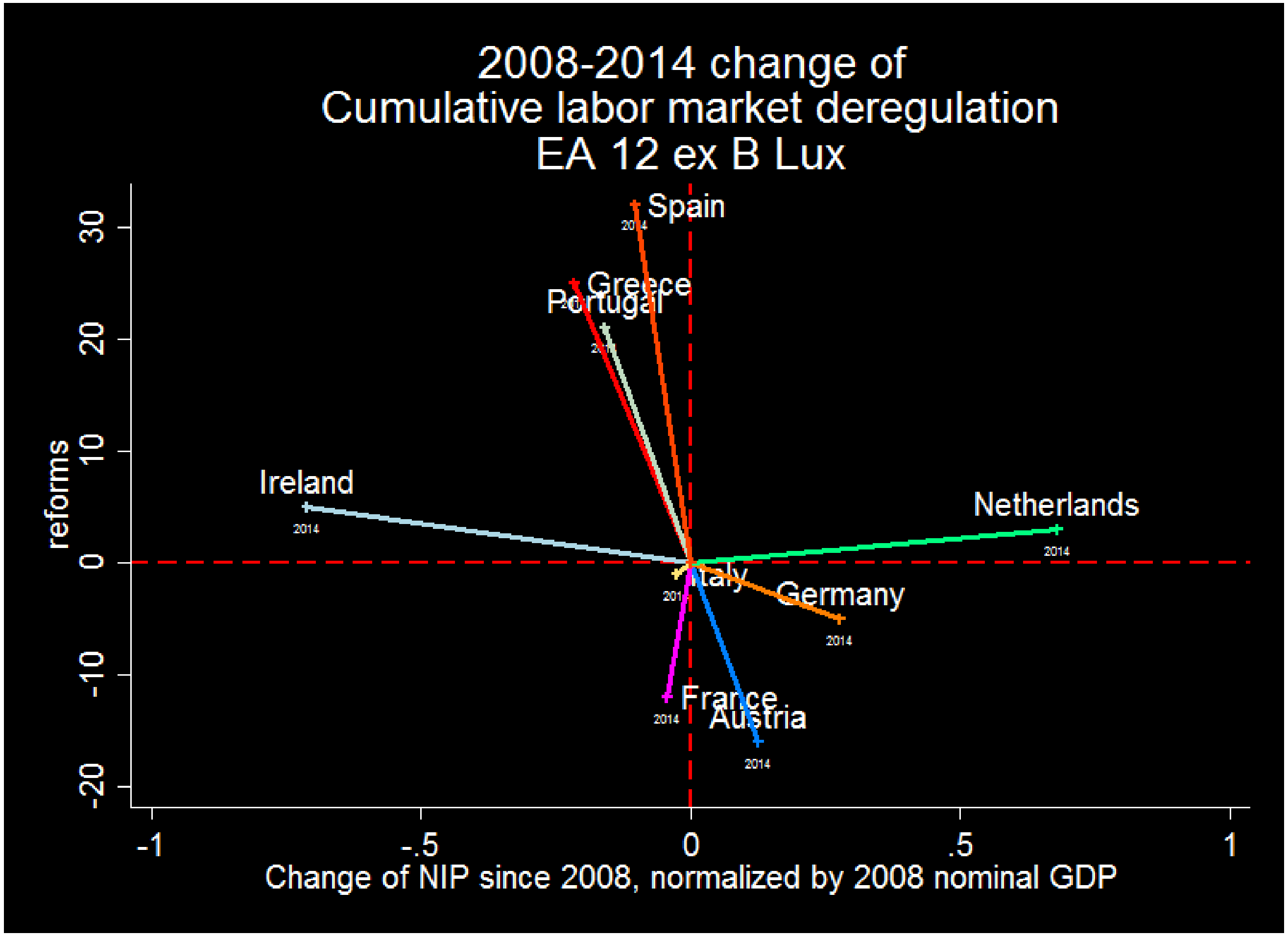
labor market deregulation



Interest rate divergence

…stubborn imbalances:

labor market deregulation



International imbalances

Labor reforms after the crisis:

- Conditionality in program countries,

  step beyond subsidiarity, but politically difficult.

- Re-regulation in core countries,

  but still excessive surpluses.

Should more be done

- on labor policy front?
- other imbalance-relevant policies?

  (also relevant to distribution as savers, surplus countries gain from austerity)

Labor policy theory and experience:

An opportunity to reflect more generally on single market’s and single money’s needed flanking measures, and politico-economic sustainability.

“The” right policy?

Not always and everywhere, not for everybody.

Need compromises, dialogue, trust.

- not enough information to design “all win” reforms. There will be losers: need hope to take turns.

- “all lose” is a definite possibility if the discussion does not recognize the need for constructive compromises.

Lack of clear discussion,

no credibility of reforms:

$\Rightarrow$ amplify instability, discourage investment.

True of labor policy,

also applicable to macro policy.

Better insights, hopefully better politics.