Can “structural reforms” of labour markets help the unemployed?

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The problem: how to reduce unemployment in (Southern) Europe?

1. After the explosion of a major financial bubble in 2008, we may enter a longer period of low GDP growth
   (see C.M. Reinhart & K.S. Rogoff: *This time is different*, Princeton Univ. Press 2011).

2. ... but even if we got higher growth, we have a real danger of jobless/job poor growth, thanks to the IT revolution
Proposition:

- It is most likely an illusion that, in the nearer future, high growth will drastically reduce unemployment in the Eurozone, notably in Southern Europe.
- Persistently high unemployment will erode the European Social Model (through “structural reforms”).

Strong competition for jobs is destructive to solidarity → Weaker trade unions → Pressure on wages and social standards; tendency to easier firing and more ‘flexible’ labour markets.
Proposition:
High unemployment in Europe has *little* to do with:
- “lack of competitiveness” or
- outsourcing to low-wage countries
... and can *hardly* be reduced through aggressive export strategies

The key problem:
*Coordinated Market Economies (CME)* have substantially higher growth rates of labor productivity than *Liberalized Market Economies (LME)* ...

... and, as a consequence, CMEs have a lower growth of labor input than CMEs! *(next sheet)*
Old Europe’s superior labor productivity performance

Development of labor productivity, 1960-2004; 1960 = 100

Labor productivity = GDP per working hour
Jobless growth in Europe and job-rich growth in Anglo-Saxon countries ...

Development of total hours worked 1960-2004 (1960 = 100)

US, UK, Canada, New Zealand, Australia

EU-12 excl. Luxemburg
## Long-run growth of GDP

<table>
<thead>
<tr>
<th>Average Annual GDP growth</th>
<th>Old Europe</th>
<th>Anglo-Saxon countries</th>
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<tr>
<td>1950-60</td>
<td>5.5</td>
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Old Europe: EU-12 (excl. Luxemburg)
Anglo-Saxon: Australia, Canada, New Zealand, US and UK
### Long-run growth of GDP and of GDP/labor hour (=labor productivity)

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<tr>
<th></th>
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<tr>
<th>Year</th>
<th>Average Annual GDP growth</th>
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<th>Growth of labor hours per 1% GDP growth</th>
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Anglo-Saxon: Australia, Canada, New Zealand, US and UK
Structural reforms of labour markets change power relations between capital and labour → lower wage growth and downward wage flexibility lead to lower labour productivity growth

Empirical estimates (20 OECD countries; 44 years) show:
A one-percent lower wage growth leads to an ≈ 0.4% lower growth of labor productivity

Source:
Why are CMEs outperforming LMEs in labor productivity growth? (1)

Deregulation of labor markets leads to “more dynamism”, i.e. more job turnover, which in turn reduces loyalty and commitment of workers:

→ more leaking of trade secrets and technological knowledge
→ more need for monitoring & control
→ thicker management bureaucracies

(next sheet)
Share of managers in the working population (19 OECD countries, 1984-1997)

According to De Beer (2001), the Dutch figure increased from 2% to 6% during 1978-98 (the period of ‘flexibilization’ of the Dutch labour market).
Why are the CMEs outperforming LMEs in labor productivity growth? (2)

Deregulation of labor markets leads to “more dynamism”, i.e. more job turnover leads to:

- Lower investment in firm-financed training
- Lower benefits from “learning by doing” and weaker “organizational memories” (learning from past failures)
- More power for top management and less critical feedback from the shop floor → more autocratic management
Why are the CMEs outperforming LMEs in labor productivity growth? (3)

Flexible firing increases risk-aversion on the shop floor: in the selection of innovative solutions, people that are easy to fire will choose less risky options → too little progression!

Why are the CMEs outperforming LMEs in labor productivity growth? (4)

- People on the shop floor possess much of the (tacit) knowledge required for process innovations. People threatened by easy firing have incentives to hide knowledge relevant to labour-saving process innovations (Lorenz, 1992, 1999)

More generally, people that are easy to fire have strong incentives hiding information about how their work can be done more efficiently (exploiting information asymmetry between management and the shop floor) → in a hire & fire regime you make poor use of the (tacit) knowledge of your workers
Why are the CMEs outperforming LMEs in labor productivity growth? (5)

- CMEs tend to have more centralized wage negotiations; wage increases force technological laggards to modernize equipment
- Other than a “Garage Business” model of innovation, a “Routinized Innovation Model” requires a continuous accumulation of (often: tacit) knowledge → need for continuity of personnel

„Tacit knowledge“ = poorly defined, ill-codified knowledge from personal experience; hard to transfer across geographical distance; often transferred through personal interaction
Conclusion:

Neoclassical theory correctly argues: deregulation of labor markets (i.e. weak trade unions, low minimum wages, poor social benefits, downwardly flexible wages etc.) leads to more employment ...

... but they do so at the cost of low labor productivity growth ...

... and hence somebody needs to sacrifice income ...

... in practical life we get a growing class of working poor with precarious jobs (and a middle class under pressure)
Two alternative strategies for capitalism:

1. **Neoliberal strategy**: Flexible labor markets; easy firing; weak welfare state (“Structural Reforms”):
   - Overall poor labor productivity growth (→ many jobs!)
   - Many working poor
   - A much more unequal income distribution

2. **European Social Model**: Rigid labor markets + strong welfare state + tough investments in education and research:
   - High speed of labor-saving technical change → Many highly productive jobs for protected insiders, but:
     - *Modest* overall job growth
     - As a compensation: shorter working weeks

Can fiscal policy help the unemployed?