

Macroeconomic Policies

Lecture 12

Unemployment and Labour Market Policies in Developed Economies

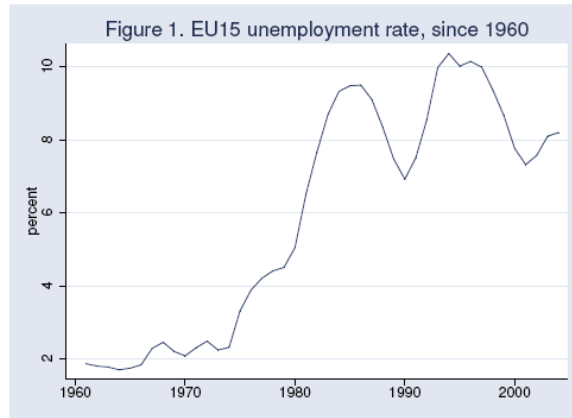
Anne Epaulard

Outline of the lecture

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1. Unemployment: some facts,
 2. Facts and theories
 3. Labour market policies

Main reference : Olivier Blanchard, 2005, "European Unemployment: the evolution of facts and ideas", NBER WP 11750.

European Unemployment since 1960



Last figures

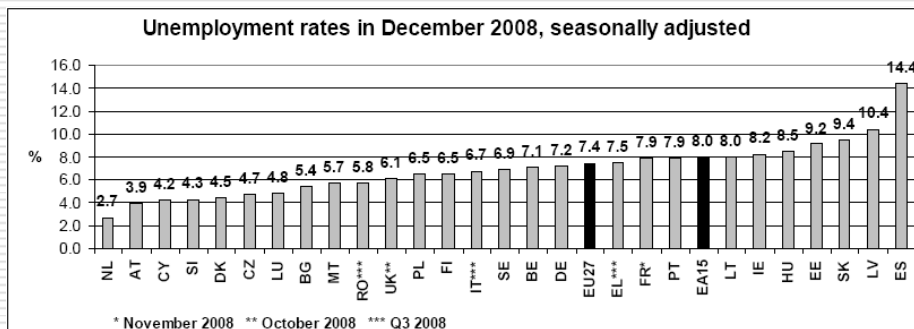
2006 : 7,7%

2007 : 7,0 %

2008 : 7,1%

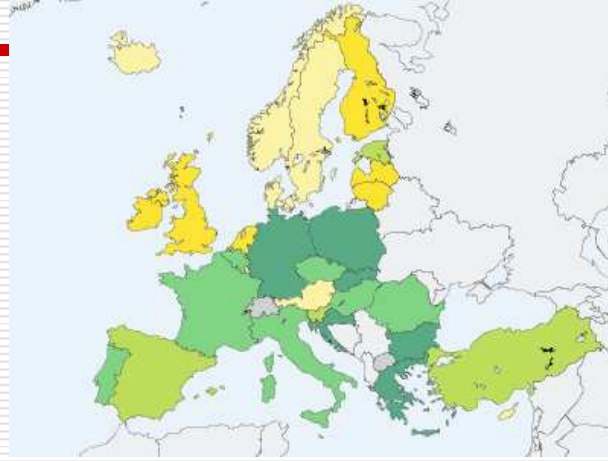
Source : Blanchard, 2005

Heterogeneity of unemployment rate



Source : Eurostat

Long term (more than 12 months) unemployment rate



Legend (Data 2007)

0.2 - 1.2

1.2 - 1.6

1.6 - 2.7

2.7 - 3.8

3.8 - 8.3

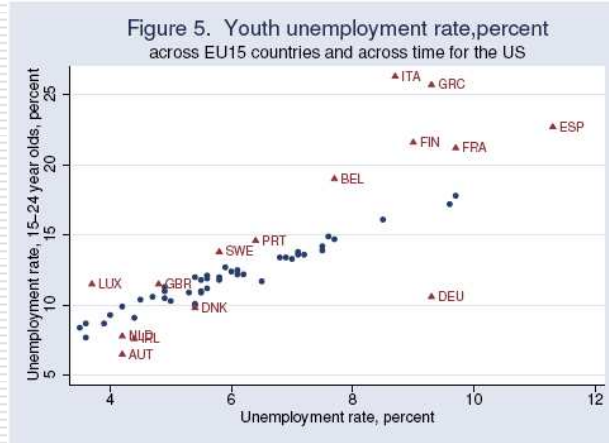
N/A

Minimum value:0.2 Maximum value:8.3 eu25:3.0 eu15:2.8

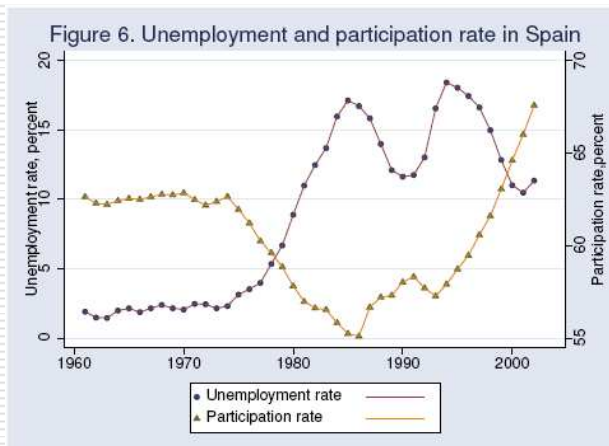
Long term unemployment went up in the 80's



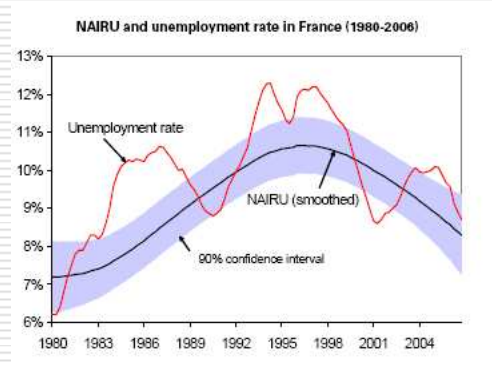
Youth unemployment rate



Unemployment rate and participation rate



NAIRU and unemployment rate in France (1980 – 2006)



Outline of the lecture

1. Unemployment: some facts,
 2. Facts and theories:
 1. Why did unemployment rise in the 70's till the mid 80's?
 2. Why did it stay at high levels ?
 3. Why did it fall in some countries but not in others ?
 3. Labour market policies
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Two macroeconomic shocks in the 70's

- Oil price went up (1973, 1979)
 - Slowdown of total factor productivity growth

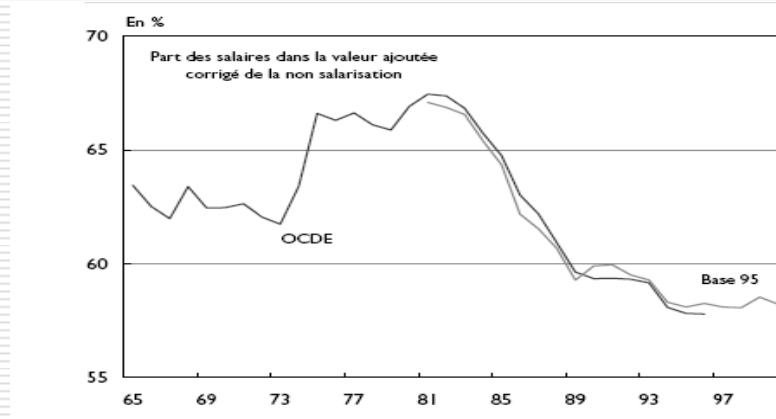
 - Why would these shocks result into higher unemployment ?
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Rigidities in the wage setting process

- Before shocks : steady rise of real wages (at the same pace at TFP growth)
 - After shocks :
 - real wages continue to rise at the same pace as before
 - Real wages rise faster than TFP
 - Real wage higher than marginal productivity of labour
 - Lower labour demand
 - Unemployment
-

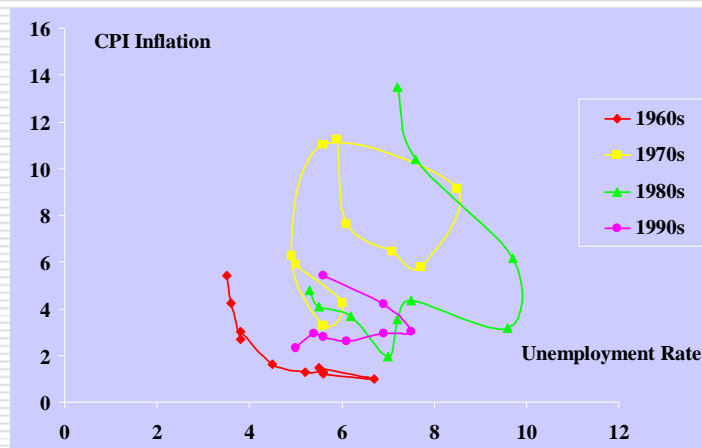
Why did unemployment rise in the 70's till the mid 80's

Despite rising unemployment labor share in GDP rise during the late 70's



Why did unemployment rise in the 70's till the mid 80's

Monetary policy, inflation surprises and unemployment



Outline of the lecture

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Why did unemployment stay at high levels ?

Shocks are no longer there

- 1986: oil prices go down
 - TFP growth doesn't go up, but wage setting has adapted to the pace of TFP growth
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Explanation of unemployment persistence

□ Hysteresis hypothesis:

- Wage setting : insiders vs outsiders
 - Human capital losses for long term unemployed
 - Tight monetary policy lead to low capital accumulation
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The role of institutions

- Labour market institutions
 - Unemployment benefit (duration, replacement rate)
 - Tax wedge on labor income
 - Level of minimum wage
 - Tax wedge on minimum wage
 - Hiring and firing costs
 - Level of wage bargaining (firm level, sectoral level, national level)
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The role of institutions

- Product and service market
 - Level of competition
 - Real estate market
 - Geographical mobility of workers
 - Financial markets
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Price setting (PS)

Simple production function : $Y = A N$

N = Employment

A = Labor Productivity = 1

Marginal cost = Wage (W)

In non-competitive markets:

$$P = (1+m)W$$

m = Markup of price over marginal cost

$$W/P = 1/(1+m)$$

The « Wage setting / Price setting » model

Demand: Firms' price setting rule

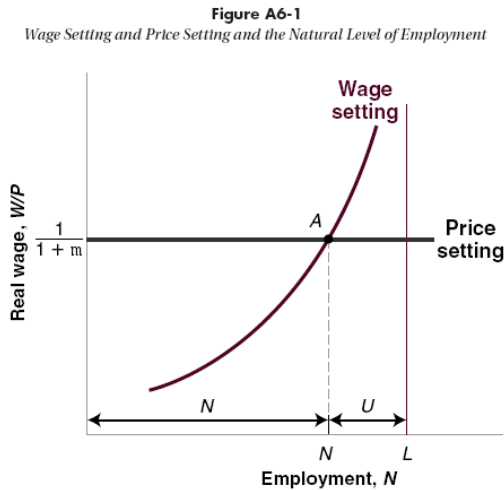
$$P = (1 + m)W$$

Supply: Wage setting

$$W = P^e F(u, z)$$

where: P^e = worker's expectations over today's prices;
 u = unemployment rate; z = institutional parameter.

The « Wage setting / Price setting » model



Changes in institutions and equilibrium unemployment in ws / ps model

- Changes in Labor market institutions
- Change in product market institutions
- Impact of lower interest rates

Empirical evidence of the role of institutions on unemployment rate

- Difficult to test:
 - How to measure institutions ?
 - rare changes in institutions
 - What matters is a set of institutions and not each institution per se (“Scandinavian model” ; “Anglo-Saxon model”)
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Empirical evidence of the role of institutions on unemployment rate

- One clear result: the negative impact of tax wedge on labor income on unemployment
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An recent empirical analysis by the OECD

- Methodology:
 - Calculating the “equilibrium unemployment rate” for countries at different points in time : estimating of the NAIRU (which can also be interpreted within the WS / PS model)
 - Look for links between change in NAIRUs and changes in policies and institutions

Source : Christian Gianella, Isabell Koske, Elena Rusticelli and Olivier Chatal (2008)
WHAT DRIVES THE NAIRU? EVIDENCE FROM A PANEL OF OECD COUNTRIES / OECD
ECONOMICS DEPARTMENT WORKING PAPER No. 649

An recent empirical analysis by the OECD / results

- The level of the tax wedge and the user cost of capital are found to be important drivers of structural unemployment.
 - The level of product market regulation, union density and the unemployment benefit replacement rate also play an important role in explaining changes in the NAIRU although there is considerable variation in estimates across countries.
 - Recent decreases in the NAIRU are better explained than the earlier surge.
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About the impact of unemployment benefits / OECD results

- The contribution of unemployment benefits is estimated to have pushed up the level of the NAIRU substantially in the 1980s early 1990s in Spain, Finland, France, Switzerland, France, and, to a lesser extent, in Australia, Italy and the Netherlands.
- Substantial cuts in the average replacement rate over the period 1993 to 2003 are estimated to have brought down the level of the NAIRU in Australia, Canada, Finland, Sweden and the United Kingdom.
- Benefits were reduced in several other countries, most notably Denmark, no significant impact on the NAIRU was found in these cases.

	Implied impact on the NAIRU						Pooled regression		Actual change in the NAIRU	Period
	Panel regression with cross-country heterogeneity						Without time dummies ¹	With time dummies ²		
	WEDGE	ARR	PMR	UND	IRLR	TOTAL				
							TOTAL	TOTAL		
AUS	0.00	0.34	-0.15	-0.35	0.89	0.73	1.26	0.65	3.06	1978-1993
AUT	1.46	0.00	0.00	0.00	0.17	1.62	0.40	0.68	4.13	1978-2003
BEL	0.35	0.00	0.00	0.13	0.68	1.15	1.04	0.78	2.62	1978-1994
CAN	0.78	0.01	-1.05	-0.14	0.51	0.12	0.97	0.95	1.77	1978-1993
DEU ³	0.02	-0.09	0.00	0.00	0.55	0.48	0.36	0.21	3.10	1978-1990
DEU ³	-0.10	-0.01	0.00	0.00	0.11	0.00	-0.91	-0.20	0.96	1995-2003
DNK	0.00	0.00	-0.53	-0.02	0.06	-0.49	1.03	1.01	2.52	1978-1992
ESP	3.66	1.32	-0.33	0.43	0.70	5.79	4.29	3.13	8.21	1980-1991
FIN ³	1.02	0.58	-0.74	1.40	0.25	2.50	2.66	2.02	3.03	1978-1990
FRA	2.34	1.00	-0.52	0.00	0.28	3.10	1.60	1.24	5.00	1978-1995
IRL	2.08	0.08	0.00	-1.62	1.92	2.46	2.82	1.87	4.10	1978-1987
ITA	1.17	0.36	-0.42	0.00	0.47	1.58	3.60	2.36	3.93	1978-1995
PRT ⁴	-	0.00	0.00	0.00	0.00	0.00	-0.34	0.16	0.44	1999-2003
JPN	0.00	0.00	-2.32	-1.52	0.00	-3.84	0.81	0.97	2.31	1978-2003
NLD	0.80	0.29	0.00	0.00	0.76	1.84	1.28	0.70	3.47	1978-1988
NOR	0.04	0.00	0.00	0.54	0.18	0.75	1.52	1.59	2.97	1978-1993
CHE	0.00	0.83	0.00	0.00	0.07	0.90	0.81	0.94	3.13	1978-2003
SWE ³	0.69	0.28	-0.04	0.00	0.16	1.10	2.69	1.96	1.26	1978-1990
GBR	0.28	-0.33	-0.30	0.00	1.70	1.36	1.28	0.80	3.77	1978-1985
USA	0.15	-0.04	-0.39	-0.06	0.45	0.13	0.79	0.69	0.31	1978-1984

Why did unemployment fall in some countries but not in others ?

	Implied impact on the NAIRU								Actual change in the NAIRU	Period
	Panel regression with cross-country heterogeneity						Pooled regression			
							Without time dummies ¹	With time dummies ²		
	WEDGE	ARR	PMR	UND	IRLR	TOTAL	TOTAL	TOTAL		
AUS	0.00	-0.38	-0.88	-0.53	-0.28	-2.08	-0.97	-0.32	-2.51	1994-2003
AUT										
BEL	-0.02	0.00	0.00	0.07	-0.15	-0.09	-0.95	-0.21	-0.19	1995-2003
CAN	0.06	-0.15	-0.43	-0.37	-0.37	-1.26	-0.84	-0.50	-1.98	1994-2003
DEU ³										
DNK	0.00	0.00	-1.46	-0.18	-0.16	-1.80	-0.58	0.24	-2.37	1993-2003
ESP	0.31	0.27	-2.53	-0.14	-0.24	-2.34	-1.53	-0.50	-3.81	1992-2003
FIN ³	-0.05	-0.25	-1.35	-0.33	-0.09	-2.07	-1.46	-0.55	-4.70	1995-2003
FRA	-0.57	0.43	-0.51	0.00	-0.11	-0.75	-0.84	-0.29	-1.28	1996-2003
IRL	-0.58	0.35	-0.88	-3.69	-1.29	-6.09	-2.32	-1.18	-10.15	1988-2003
ITA	0.15	0.32	-1.38	0.00	-0.21	-1.13	-0.92	0.01	-1.74	1996-2003
PRT ⁴	-	0.00	0.00	-1.30	0.00	-1.30	-0.03	-0.06	-1.29	1980-2001
JPN										
NLD	-2.01	-0.11	-0.82	0.00	-0.69	-3.63	-3.54	-1.65	-3.14	1989-2003
NOR	0.15	0.00	0.00	-0.46	-0.20	-0.51	-1.08	-0.36	-0.86	1994-2003
CHE										
SWE ³	0.03	-0.15	-0.12	0.00	-0.08	-0.33	-0.77	-0.32	-0.15	1997-2003
GBR	-0.36	-0.48	-2.72	0.00	-0.60	-4.17	-2.20	-0.98	-4.58	1986-2003
USA	0.15	-0.01	-0.46	-0.27	-0.37	-0.96	-0.74	-0.21	-1.32	1985-2003

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Objectives of current market policies

- For low unemployment countries the concern has shifted from lowering unemployment to raising labour force :
 - Increase participation rates (young adults, seniors, women)
 - Increase the average number of hours worked (NL)
 - For high unemployment countries lowering unemployment is no longer the only objective.
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Protect workers, not jobs

- Aim: protecting workers while allowing for reallocations (between sectors, within sectors between firms)
 - “Flexicurity”:
 - Generous unemployment benefits (in terms of level), but conditional to acceptance of jobs
 - Training and life-long learning
 - Better efficiency of placement services
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Make work pay / reduce labor cost for low skilled workers

- To achieve:
 - High employment rate amongst low skilled
 - Keep low level of poverty
 - Complex articulation of:
 - Minimum wage ("Smic" ; "low pay commission")
 - Negative income tax ("PPE")
 - Low tax wedge for low skilled workers
"allègements de cotisations sociales")
 - Minimum income ("RMI")
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