Euro-Productivity and Euro-Jobs since the 1960s: Which Institutions Really Matter?

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Two police cases that should be one:

- Finding culprits that killed European jobs since the 1970s (labor economics police)
- and
- Finding culprits that lowered Europe's GDP per person relative to the USA (growth police)

The labor market police case

- Euro-jobs are the victim, and labor institutions are the suspects -- dole, minimum wage laws, EPL, payroll taxes, policies for early retirement and disability, centralized wage setting
- (e.g. *OECD Jobs Study* 1994)

The Euro-growth police case

- Growth-theory and production-function suspects -- product-market competition, technology, R&D, higher education policy, retailing restrictions vs. Walmart revolution, etc.

(e.g. Robert Gordon, Olivier Blanchard)

The two cases need to be solved together

Most institutions that affect jobs affect productivity, and vice versa.

Issue: Which institutions and policies affect them both in the same direction, and which have offsetting effects, leaving GDP much the same?

Five conclusions :

(1) The clearest culprit is a protectionist policy syndrome featuring employee protection laws (EPLs).

These cost jobs, without helping productivity.

Five conclusions, continued:

(2) One other kind of European labor-market intervention -- centralized wage bargaining -- has raised both jobs and productivity.

Five conclusions, continued:

(3) The superiority of bargaining over legislating in labor markets helps to explain the renewed rise of Northern Europe relative to Southern Europe.

Five conclusions, continued:

(4) On taxing work, conventional wisdom is only narrowly correct.

Payroll tax wedges do cost jobs – but raise productivity. The dole does cost jobs and productivity – but only relative to other social transfers.

Five conclusions, continued:

(5) In the real world, high taxes and transfers bring no overall loss of jobs or GDP, confirming the "free lunch puzzle of the welfare state."

Five conclusions, continued:

That is, any European losses from the usual fiscal culprits (payroll taxes, unemployment compensation) are cancelled by efficiency in other social transfers -- health care, public support for mothers' careers, and maybe ALMPs.

Some historical contours since 1960

- OECD 21-country policy averages (Figure 1) reflect trends in Europe.
- Only two policy interventions declined: Government regulation of 7 product markets, and (slightly) coordinated wage setting.
- All others rose, especially before 1985.

Better measures of labor-market institutions

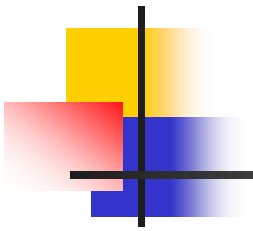
Allard (2003, and home page) found it necessary and possible to improve on OECD measures of three institutions:

- The generosity of unemployment comp.
- Strictness of EPLs protecting employees against dismissal
- Collective wage setting

Better measures, continued

The new measures for 1950-2003 are based on a reading of statutes, not expenditures or economic outcomes.

They seem econometrically exogenous to cycles in jobs or GDP.



The Allard measures of unemployment compensation go beyond ye olde replacement rate. They incorporate

- the replacement rate,
- the coverage rate (share of unemployed who are eligible for benefits)
- the take-up rate (share of eligibles who receive benefits), and
- the duration of coverage, up to one year.

Better measures, continued

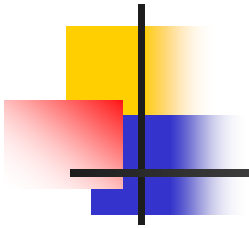
- Unemployment compensation jumped between 1963 and 1985 (Figure 2).
- Two countries whose unemployment comp. had soared slashed it in the late 1980s (Netherlands, New Zealand)
- EPL strictness (Figure 3) followed similar trends, but with less dramatic reversals after the late 1980s.
- Coordinated wage setting was steadier on average, but with major changes in individual countries.

Better tests

Why not stick to micro-samples, to get the behavioral details right?

- First limitation: Most micro-labor samples are not policy experiments. Few major changes in policy regime within the sample (e.g. for tax regimes, only slight differences among U.S. states). There are good exceptions, like the NIT experiments.

- Second limitation: It is misleading to use estimates of labor supply elasticities to quantify the job effects of taxes and dole. By implying an infinitely elastic labor demand, such labor supply studies overstate the job effects of any change in labor supply incentives.



- Third limitation: Labor-market partial equilibrium means poor counterfactuals.

If we are considering a rise in the tax rate on employment, what happens to the revenues?

What happens to capital formation, and the whole set of factor prices?

Won't these extra channels affect jobs and growth too?

Macro-econometric panels: still needed

- Macro-econometric panels still risk mis-judging differences in structure over time and space, but …
- they have the virtue of covering the whole economy in contrasting institutional and policy environments.
- We use the 1978-2001 and 1963-1980 histories of 21 OECD countries….

Simultaneity and non-linearity

(See Table 1)

… with pooled two-stage GLS tests designed to address

- Simultaneity -- possible feedbacks from the economy to the institutions are controlled with instrumenting and exclusion restrictions (with extra cyclical adjustments for some budgetary variables)
- Non-linearity in the theoretically predicted effects of any fiscal wedges.

Revealed impacts, 1978-2001
(see Table 2)

- The non-policy control variables (esp. age distributions and OECD-wide macro shocks) are powerful in all equations
- Product-market regulations lack robust effects here.
- Job protection laws (EPLs) seem to reduce both jobs and productivity.

The EPL result confirms earlier warnings: can't fire, don't hire

	Lose jobs (layoff rate)	Leave unemploy't	Share of U longer than 1 year
EU 1988	0.3	5.0	55%
US 1988	2.0	45.7	7%

Revealed impacts (Table 2 continued)

- The costs of EPLs may also reflect other policies that EPLs lead to: subsidies for early retirement, and for "disability."

- By contrast, collective wage-setting seems to raise both jobs and productivity.

What about fiscal wedges in the labor market? (Table 2, continued)

- More generous unemployment compensation does cost jobs and productivity -- relative to other social transfers. A conventional result.
- The much-studied payroll tax wedge also costs jobs -- but raises productivity.

Revealed impacts (Table 2 continued)

- The story changes when we look at all taxes and all social transfers. No significant losses of jobs, productivity, or GDP. The "free lunch puzzle" once again.

Verdicts on other suspects

- Tax mix (income and property taxes vs. sales taxes vs. social security contrib's) not a robust effect in these tests.
- The probably negative job effects of early retirement and disability subsidies are hidden within other budget categories here.

Other suspects, continued

- Active labor market policies (ALMPs) were measured, but had to be dropped from the tests here -- too sensitive to cyclical feedback, regardless of the choice of instrument.
- Openness to trade not a systematic influence here, because it varied so little within this recent-OECD sample.

Other suspects, continued

- Technology, non-human capital, and human capital are hidden in most of these equations. They are masked by the lagged dependent variable here, though their effects are suggested indirectly in side-tests.
- Minimum wage laws? Not enough data.

Fixed country effects?

- Adding them drives all other effects toward zero, though macro-control variables and collective wage setting remain significant.

- But what do fixed effects represent? The frequent assumption that they represent "other unobservables" assumes they are uncorrelated with the fixed-country part of the observables. Not true here.

Fixed country effects, continued

- Table 3 reveals that the regressions' fixed country effects are strongly correlated with the country-specific averages for some of the visible variables, and not with others.

- What pass for separate fixed effects partly reflect forces already discussed. It just happens that history's panel features the fixed-country parts of these forces.

Fixed country effects, continued

- For example, some fixed country effects reflected educational attainment. Higher-education countries like the US had consistently more jobs and GDP, cet. par.

- The country averages for EPLs correlate negatively with fixed effects for productivity, again hinting and their durable costs since the 1970s.

And earlier, in the 1960s and 1970s?

- Statistical work still in progress.
- So far, policy effects all looked weaker in the 1960s and 1970s (other than positive role of collective wage bargaining).
- Could the effects have taken time to emerge, after 1980?

Conclusions

- Some institutions and policies intervening in the marketplace are costly, some are not.

- Protectionist legislation, here represented by EPLs, cost jobs and productivity.

Conclusions, continued

- Cooperative solutions in wage setting had positive effects.
- Who got it right, shifting toward higher coordination/lower EPL strictness? Sweden, Netherlands, Ireland …
- Who got it wrong, dropping coordination with stiff EPLs? France, Italy, Greece.

Conclusions, continued

- "Free lunch puzzle" lives on:

  The welfare-state package, with high tax shares funding high social transfers, may have had zero cost. The negative effects of more unemployment compensation and payroll taxes were offset by productivity-enhancing social programs.