Discussion

1. Judith Sloan

Richard Jackman's paper is a very useful contribution to this volume. His paper reminds us that unemployment is not a simple story, even though present day comparisons between unemployment in Europe and in the United States might suggest that it is. He makes three very strong points. First, it was not always so that unemployment in Europe was higher on average than in the United States; in the 1960s and 1970s, the reverse was true. Second, there is more variability between unemployment rates within Europe than there is variability between the rates of unemployment in Europe and the United States. In other words, some European countries (mainly ones with small populations) have relatively low unemployment rates while some other European countries have relatively high rates. Some European countries with relatively low unemployment in the mid 1990s are: Denmark, the Netherlands, Austria, Norway and the United Kingdom. The third point that Jackman makes is that the ranking over time of European countries in terms of their unemployment record has not been stable. Some countries which experienced relatively low unemployment in the 1960s and 1970s – Sweden and Germany are examples – are now high unemployment countries.

Jackman also warns us about the danger of placing too much confidence in cross-country regression analysis which is a common technique used to explore the causes of unemployment. In addition to the relatively small number of developed economies for which there are reliable data, there are relatively few observations relative to the potential number of independent variables. He also makes a case for excluding Japan from cross-country comparisons, given the uncertainty surrounding the reliability of the unemployment figures for that country.

Two additional points can be made. First, there is a degree of arbitrariness in the classification of some of the variables used in these cross-country comparisons. This is particularly acute in the case of the classification of the degree of centralisation of wage bargaining in particular countries, on the one hand, and of the strength of employment protection laws, on the other. In the former case, many countries will typically combine elements of centralised and decentralised bargaining, in which cases the category into which these countries should be assigned is very unclear. As far as the strength of employment protection laws are concerned, the 1996 OECD *Employment Outlook* ranks Australia as 4, while it puts Belgium at 17. At first blush, it is difficult to place much confidence in the proposition that Belgium's employment protection laws are four times stronger than those of Australia.

It can also be argued that the unemployment rate is not the most appropriate dependent variable. Not only are there some differences in measurement (although in theory the standard US definition of unemployment is used throughout the OECD), there are wide variations in the activities of non-employed persons across developed countries. In particular, wide variations in the take-up rates of various types of disability pensions and the use of early retirement schemes can distort comparisons of countries' unemployment rates. Likewise, the use of public employment to ramp up overall employment can distort

comparisons of countries' employment to population ratios. It is proposed in this commentary that changes in the ratio of private sector employment to population is the preferred measure of the strength of a country's labour market over time.

One of the central questions posed by Jackman in his paper is this: are Europe's current unemployment problems the result of rigid labour market institutions? He notes that Europe enjoyed relatively low unemployment in the 1960s and 1970s, notwithstanding the rigid labour market institutions that existed at that time. Does this therefore suggest that the explanation of Europe's unemployment problem lies somewhere other than the inflexible regulatory framework governing most of Europe's labour markets? Jackman argues that there are a number of responses to this conundrum, including the proposition that the cost and complexity of the regulations affecting many of Europe's labour market have in fact increased over time. A similar point could be made about the institutional arrangements governing Australia's labour market. Notwithstanding some relatively recent reforms, it is possible to list a large number of developments from the mid 1960s that have significantly altered the institutional landscape of Australia's labour market. This list includes the following:

- the aftermath of the O'Shea affair in the late 1960s and the effective demise of the penal provisions against industrial action;
- the spread of long service leave as a standard award benefit;
- the spread of leave loading as a standard award condition;
- the spread of superannuation benefits as a standard award conditions;
- the spread of parental leave and, more recently, carer's leave, as standard award benefits;
- the termination, change and redundancy (TCR) clauses in awards setting out consultation requirements and minimum redundancy payments;
- the minimum rates adjustment process whereby the award pay of low-wage earners was lifted through increased supplementary payments; and
- the strengthening of federal employment protection provisions from 1993.

Taken together, the effect of these changes was to raise labour costs, *ceteris paribus*, since most of the changes effectively added to the cost of employing workers – certainly full-time, permanent workers. The relevance of this discussion is that in Australia, as elsewhere, it is incorrect to assume that labour market institutions have been static; any explanation of unemployment must therefore take into account the changes thereto.

As Jackman notes, one of the interesting features of European unemployment is the relatively superior performances recently of some of the smaller countries, *viz.* the Netherlands, Austria and Ireland, although in the latter case, the rate of unemployment is still high but falling. All these three countries operate a consensus-based incomes policy. There is the broader issue, however, of the virtues of 'smallness', both geographically and in population terms. In order to develop 'encompassing coalitions', to use Mancur Olson's (1971) term, it is necessary for all groups to be aware of the source and magnitude of negative spillover effects generated by others. If these spillovers are not obvious, it is much more difficult to generate an environment in which groups will desist from generating these spillovers in the first instance. Smallness may be one feature of such a conducive environment.

By the same token, these countries have undertaken policies in addition to a centralised incomes policy which may be the key to their unemployment results. For instance, the minimum wage was reduced in the Netherlands and, in Ireland, sound fiscal policy has been instituted. On this last point, the evidence would appear to support the requirement of prudent fiscal policy in terms of generating an environment of low unemployment, in combination with other features. In France, for instance, the *franc fort* policy was detrimental to employment growth, irrespective of the institutional arrangements in that country.

Returning to the core of Jackman's paper, my main criticism is that the conclusion does not flow from the substance of the paper. Midstream, he argues that '[it] may be possible to balance the adverse effects on unemployment of particular institutions (which may be desirable on other grounds) by further appropriately designed interventions which hold unemployment down' (p. 49). This implies, for instance, that a country can run with strong employment protection laws which increase unemployment but offset the adverse effects by pursuing active labour market programs. In other words, there are various, feasible trade-offs that can be welfare-enhancing as well as compatible with low unemployment. In the conclusion of the paper, however, Jackman argues that '[the] model suggests that interventionary policies may assist in the short run, but in the long run they may make things worse' (p. 60). Of particular interest are his conclusions that 'big bang' reforms will lead to higher unemployment in the short run but lower unemployment in the long run, whereas interventions to reduce unemployment may succeed only in the short run or require additional interventions to produce sustained low unemployment over time.

Admittedly, Jackman's model is rudimentary but it does highlight the dynamics of the process and the lags between policy action and final outcomes. Unfortunately, we do not understand very well either the nature or duration of these lags. In addition, it remains unclear, among the range of regulatory interventions in labour market, which really bind and which effectively match the market and are therefore neutral in their impact. There is scope for important further research in both these areas.

Overall, Jackman's paper is a useful contribution to the debate on unemployment. Given the fashion of comparing the US and Europe in total, his paper is a useful reminder of the diversity of outcomes across European countries and the variability over time. The answers are much more complex than simple comparisons between the US and Europe allow. His model highlights the importance of the government's objectives in respect of unemployment and the potentially perverse effects of interventions when the outcomes are viewed dynamically.

References

Olson, M. (1971), *The Logic of Collective Action: Public Goods and the Theory of Groups*, Harvard University Press, Cambridge, Massachusetts.

2. General Discussion

Discussion of the papers by Larry Katz and Richard Jackman focused on four issues:

- the role of income mobility in offsetting inequality in income distribution;
- the labour market experiences of different sections of the population;
- the analysis of shifts in the natural rate of unemployment; and
- the complementarity of policies and institutions in labour market adjustment.

Some participants noted that greater inequality in the distribution of income would not be such a problem if there was a large degree of income mobility. That is, if workers enter the workforce at the lower end of the income distribution but move up the distribution over their working lives, from a lifetime perspective, inequality would be less of an issue. It was noted that across countries, those with greater income inequality appear to exhibit greater income mobility. However, in the US, there has been little change in income mobility to offset the widening in the income distribution in the past two decades.

There was some discussion of the varied labour market performance of different groups of labour market participants in different countries. The employment to population ratio of prime-aged males in the US has declined in recent years, and does not compare favourably with the European experience for this group. Some part of this is due to the high levels of incarceration of prime-aged males in the US. However, for nearly all other labour market groups, the employment to population ratios are much greater in the US than in Europe. In particular, it was noted that the US had been very successful in absorbing the increase in the labour supply of females. It was argued that this difference was in part the result of labour market regulations and institutions primarily being designed to protect the jobs of prime-aged males in Europe, whereas this was not the case in the US.

Estimates of the natural rate are generally imprecise, so it may be difficult to discern movements in the natural rate through time. Consequently, some participants suggested examining movements in the Beveridge curve, which plots the relationship between unemployment and job vacancies. However, for the US, the Beveridge curve is difficult to estimate because of unreliable vacancies data. This has been further complicated by an increased reliance on temporary help agencies in matching workers looking for jobs with vacancies, which has reduced the number of measured vacancies. One participant noted that when comparing Beveridge curves across countries, it was important to bear in mind that differences in wage-setting institutions will shift an economy along a given Beveridge curve as well as shift the curve itself.

Finally, most participants agreed that it was essential to consider labour market institutions and policies as a whole when assessing their impact on labour market outcomes, and when considering a set of policy measures to reduce unemployment. There are complementarities between policies so that the total impact of a set of labour market reforms implemented concurrently is likely to be greater than the sum of the impact of the reforms implemented in a piecemeal fashion. Furthermore, introducing only one reform in isolation from other reforms is likely to reduce its impact. Participants noted that there is both empirical and theoretical evidence of the importance of the complementarities.