

The Role of Structural Policies Meant to Promote Employment

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1. - Introduction

The subject of this lecture might well meet the intention of Professor Mario Baldassarri who wrote that the lecturer should speak of «a relevant topic for the current economic and policy debate». My subject might meet this intention, if it was not for the fact that it had been already so much debated that there might be very little to add. Actually, I should like to stress the academic challenge, probably more than was done by others speaking about the same subject. This should be suitable for this speech, taking place within the *Angelo Costa Award ceremony*, in front of the most promising Italian graduates in economics, among whom we are likely to see those who will contribute to meet the challenge in question.

You know the facts: all along the past two decades the dominant concern about the economy was unemployment. The role of market rigidities in explaining the phenomenon was recurrently debated, particularly in Western Europe. Whether structural reforms were needed in order to restore something like full employment was also much discussed, as well as which reforms would be most effective for the purpose.

N.B., the numbers in square brackets refer to the Bibliography at the end of the paper: [JEL Code: J38, J58, J68]

If the debate and discussions were so enduring, it was not mainly because the terms of the issues would have changed, although they did change somewhat. It was not mainly because debaters had different economic and social priorities. It was rather because we found it so difficult to settle the main issues on the basis of objective and fully persuasive assessments. Part of my purpose today is therefore to exhibit what are these challenging deficiencies in our knowledge.

We certainly learned a lot during the past two decades. We economists have to transmit this new knowledge to our fellow citizens and to be obstinate in explaining repeatedly its implications. But we should also be aware of the limits of our understanding, recognize them explicitly and propose what we reasonably believe to be the best strategy, given what is the real state of objective knowledge. Such is the spirit in which I shall try to speak here today.

My talk aims at examination of structural policies. However, it will begin with a first part devoted to the distinction between macroeconomic and structural policies, as well as to the interplay between the two. This will clear the ground for the following parts. The second part will deal in general with structural policies, considering three general questions about them. The third part will be devoted to a closer discussion of some important structural policies.

2. - Macroeconomic Policies and Structural Policies

Four reasons led me to decide that I should begin this lecture by a part in which I would put in place the respective positions of macroeconomic policies and structural policies: 1) semantic uncertainties; 2) a frequent underrating of the responsibility of macroeconomic policies; 3) present business trends, which seem to require a reassessment of the role of structural policies; 4) difficulties with the concept of a structural unemployment rate and with its measurement. I am now taking each of these four reasons in turn.

2.1 *Semantic Indecision*

What do we mean by respectively macroeconomic policies and structural policies? It is clear for everybody that demand management policies are macroeconomic and that institutional reforms are decided and implemented by structural policies. But these two cases do not cover the full range of policies, far from that. Since it is convenient, particularly in this talk, to have a distinction between only two groups of policies among those meant to promote employment, we should have principles which will show how to decide in each particular case. But the language is hesitant. For some writers, all policies which are not mainly targeted at aggregate demand are structural. I do not think that such a convention provides a satisfactory criterion.

The word structural conveys the notion of policies that, without being necessarily irreversible, are adopted for a substantial time-span. Indeed, they bear on the legal, conventional or factual structures of the economy and society. Changes in the structures require time to be implemented and still more time to entail significant effects. In contrast, macroeconomic policies aim at quick responses of the short-run trends in output and prices. They are essentially temporary and ready to shift the values of instruments as soon as the macroeconomy shows signs that prospects two or five years ahead have to be revised.

Let me refer for a minute to another expression, namely "supply policies", which is also often used beyond what it literally means. Many policy decisions put under the label of supply policies do not directly target more at supply than at demand. If anything, their intended impact on markets in such cases concerns the process of adjustment between supply and demand. For instance a policy aiming at changing the level of centralization of wage bargaining is a structural policy but not a supply policy, whereas a policy of wage restraint aimed at restoring business profitability is a macroeconomic supply policy, not a structural policy.

Another example in the same area also suggests where the borderline between structural and macroeconomic policies should

be: instituting a legal minimum wage is a structural decision; changing the level of the minimum wage is a macroeconomic decision. Still another example: fiscal policies are macroeconomic when they concern a deliberate stimulation of the public demand for goods and services, or alternatively an across the board cut in public expenditures; but they are structural when they mean an overall reshaping of tax codes, the institution of a negative income tax or of an earned-income tax credit.

These various examples and what I said before introducing them should suffice in order to show what I shall mean by the expression structural policies in this lecture. Clearly, the borderline between macroeconomic and structural policies is not absolutely marked, but my definition should be easy to apply in most cases. I note that it leaves a larger scope to macroeconomic policies than is often suggested.

2.2 A Frequent Underrating of the Responsibility of Macroeconomic Policies

At this point a quick reference to my diagnosis of Western European unemployment will avoid misunderstandings about the message of my talk today. You are certainly aware of the thesis according to which unemployment in our part of the world since the middle seventies was mainly due to labour market rigidities, or to “Eurosclerosis” more generally¹. Unemployment persistence would reflect the fact that our countries failed to adopt sufficiently strong structural policies, which would have made their economies much more flexible. You might have thought that my choice of the subject of this talk reveals my support of this thesis. That would be wrong inference.

Quite the contrary, like many other macroeconomists, I believe that the thesis is misleading because it underrates the responsibility of macroeconomic policies. Those policies in Europe failed to properly act in two crucial periods: first, during the late

¹ See for instance SIEBERT H. [14].

seventies, early eighties; second, during the years 1992-1996. But this is easy to demonstrate, hence less challenging than to evaluate the part of responsibility to allocate to Euroclerosis. Moreover, as I shall explain in a minute, the time may be now approaching when structural policies will become particularly important for reaching full employment. Hence, my subject is not only challenging, but also more relevant for the policy debate now than it would have been five years ago.

The claim that past failures of macroeconomic policies are easy to demonstrate may arouse your curiosity about the course of my demonstration. Dwelling on it beyond a few sentences would be out of place. But here is the main line of argument². In the late sixties and early seventies, the need for Western European economies to quickly adapt to the entry into a new phase after the exceedingly favourable earlier decade was not correctly perceived, neither by people, nor by firms and their workers, nor even by governments. The ensuing unsustainable inflation and loss of business profitability, followed by further decline in profitability when inflation was barred, would have required an early policy of wage restraint. At least from the summer of 1992 a sharp debt-deflation was manifest. It should have provoked from our countries a concerted common shift to significantly lower short-term interest rates. If these two macroeconomic policies had been respectively adopted in the two cases, Western Europe would have avoided large parts of the unemployment surges that then followed, surge of classical unemployment in the first case, of Keynesian unemployment in the second.

2.3 Macroeconomic Trends in the Last Few Years May Make Structural Reforms Particularly Urgent

The situation is, of course, much better now than it was during the two periods I just recalled, since the unemployment rate of the European Union decreased from more than 11% in 1994

² The full argument may be found in a section of MALINVAUD E. [7] p. 1445-52.

to 8.5% now. But can we expect the macroeconomic trends which generated such a favourable evolution to persist? You know that the main dilemma in the conduct of macroeconomic policy comes from the inflationary demand pressures which may appear in good times and then have to be contained by measures depressing demand, hence also depressing employment. You remember that in 1989 it was exactly what happened.

The remarkable performance of the United States during the last decade certainly shows that reducing unemployment to definitely lower levels than we thought a few years ago is feasible in a market economy without necessarily fuelling inflation. But precisely, the structures of the American economy provide more flexibility than do those of the European economy. For this reason many economists believe that what has been achieved in the USA cannot be repeated in Western Europe, unless important structural reforms are implemented in our region.

Some signs may give credence to this idea. Even with still high levels of unemployment in most European countries, the number of firms reporting difficulties in finding the employees they would like to recruit has greatly increased. Even though investments have been important during the last three years, the rates of capacity utilization in manufacturing are estimated to be quite high. These signs of demand pressure have not yet resulted in demand inflation (the surge of cost inflation coming from depreciation of the Euro and increase in oil prices are not significant for the purpose of this talk). But all indicators that are relevant in the analysis of demand inflation have to be closely watched by forecasters from now on.

As I shall explain in a minute, we cannot measure the level below which a further decrease in European unemployment would not be long sustainable with our present structures. We have to face that fact and recognize that a first important uncertainty in our knowledge makes us feel quite uncomfortable at this time when we see manifest signs of demand pressure. The wise and prudent behaviour is, however, to act now almost as if we were sure to be already closely approaching the minimum long-run sustainable level of unemployment, given our present structures. This

means that we should examine structural reforms, select at least those which would be both appropriate in the long run and beneficial for employment in the short run, then implement such reforms quickly.

2.4 Difficulties with the Concept of a Structural Unemployment Rate and its Measure

Before going into the examination of structural reforms, let me still comment on the concept of a structural unemployment rate, which is suggestive, attractive and often used. The denomination suggests a rate of unemployment resulting from our economic and social structures. It also suggests that a measure of this rate can be so calibrated that it coincides with what I just called the minimum long-run sustainable rate of unemployment given the economic and social structures. This makes the concept quite attractive.

Indeed, assume that such a concept has become a reliable working tool of macroeconomics. Structural reforms can be gauged by their likely effect on this structural rate, at least as long as employment is the concern: a reform is favourable if it lowers the rate in question because, when adopted, the reform gives an extra margin of manoeuvre to macroeconomic policies in their dealing with the dilemma between inflation and unemployment. Conversely, an independent measure of changes in the structural unemployment rate through time evaluates the net balance of employment gains or losses due to structural changes.

The concept is so attractive that it is actually used as a main reference by OECD in assessing where various countries stand with respect to the implementation of structural policies which the Organisation considers to be required for full employment (OECD [11]). Careful readers of the document will, however, realize that the value of this reference was seriously debated within the staff.

The fact is reflected in the long text of Box 1.1 of the publication (p. 18). From this text I draw the conclusion that we can-

not give any credence to the concept as measured and used there. It is no better than any other series of the recorded unemployment rate, smoothed for elimination of its short-run fluctuations. The denomination structural unemployment rate can only arouse confusions. Let us read the box, considering what it says about the measure and the reasons in favour of the denomination.

«Structural unemployment is proxied by the OECD Secretariat time-series estimates of the non-accelerating-wage rate of unemployment (NAWRU)... [This] is a short-term concept. It indicates the rate of unemployment that, in a given year and based on the actual history of unemployment, would be associated with constant wage inflation... While the long-run equilibrium rate of unemployment is largely determined by structural factors,... the NAWRU may deviate from it when labour markets are affected by macroeconomic shocks». – At this point, a footnote within the box writes – «In the context of the structural policy recommendations of the *OECD Jobs strategy*, estimates of the long-run equilibrium rate of unemployment might, in principle, be more appropriate compared with the NAWRU. However, these estimates are difficult to obtain...». Readers should conclude that the NAWRU is not a reliable measure for knowing what are the long-run effects of structural policies.

I just add that I give no more credence, for a valid measure of structural unemployment, to estimates of «the equilibrium rate of unemployment», as published by other authors. These estimates again result from time-series fits, but on models which include the assumed impact of some structural changes. Any estimate of that type depends on the specification of the model. In all cases the models are too simple for well capturing the global long-run employment effect of structural changes, which are very diverse and, in most cases, generate a number of repercussions along complex causal chains.

3. - Prolegomena for an Agenda of Structural Reforms

Consideration of macroeconomic policies being now cleared

away, we may concentrate on structural policies. We may think in terms of aiming at defining what could be a programme of reforms and at assessing the contributions to employment to be expected from the various pieces of this programme. Three preliminary remarks must then be made: 1) the objective of the programme is more than reducing unemployment; 2) ideas about the content of the programme have somewhat evolved during the last decade; 3) any assessment of effects on employment puts a challenge that econometric research is not able to perfectly meet. I must explain what I mean by each one of these remarks.

3.1 *Objectives*

The objectives of long-term policies cannot only be to solve a temporary problem. They must also fit long-run concerns about what the economy, or even the society, should achieve. In this broad framework the fundamental meaning of full employment appears.

In modern societies the degree of inclusion or exclusion of people, and their *status*, are defined first and foremost with reference to work. The right to work is perceived to be a corollary of human dignity. Full employment, as a political objective, has to achieve high probabilities of employment to all categories of people who choose to so work. When we start from a situation of high (open) unemployment, the objective is then to provide work not only to many unemployed, but also to many others who now do not exhibit their latent labour supplies because they know they could not find jobs. The objective then is to raise rates of employment, rather than just lower rates of unemployment.

There are also qualitative objectives as to the nature of jobs, the remuneration of work and the form of employment contracts. It would be too long to discuss what the objectives exactly mean in our fairly affluent societies and in our age where productions are quickly changing and have to be flexible. Only occasional and quick reference to them will be made later on. I want nevertheless to mention at this point a specific objective which concerns

our welfare states and partly explains why we now assign a broader scope to our programme of structural reforms than we did ten years ago.

Most workers feel that they have not only a right to work but also a duty to work, so as to bring their contribution to the common effort of the society in which they live. They also think that this contribution deserves remuneration. Hence, they resent a lapse from equity when they see cases in which accepting a job does not pay because, all being taken into account, the wage does not even cover the loss of welfare transfers which accrued before. The concern for social equity so meets the concern for efficiency in stipulating that work must pay.

3.2 About the Content of a Structural Policy Programme

The *OECD Jobs Study* published in 1994 was the result of a major investigation requested in May 1992 by Member States, most of which wanted to better know which structural policies would improve employment. As a result and after signaling the importance of macroeconomic policies, the Organisation made eight main recommendations, each of which concerned a structural target and a number of policy measures aiming at this target. Five recommendations concerned the labour market (unemployment benefits and related issues, employment security provision, working-time flexibility, labour-costs flexibility, active labour market policies), a recommendation bore on education and training, another on technological know-how and its development, finally a recommendation aimed at promoting entrepreneurship.

The complete programme, which cannot be described in details here, still serves OECD as the reference in its discussion of structural policies. But some significant changes discreetly occurred in the presentation. I may note the following ones. Aware of equity considerations that had often been raised in the context of implementing the recommendations, OECD [11] examines not only aggregate employment and unemployment but also the dis-

tribution of job opportunities, job security, as well as earnings and income, amongst different groups of the working-age population. A brief reference to product-market competition within the earlier wording of the recommendation on labour-costs flexibility has been transformed into a full new main recommendation. The increasing attention now given to a frequent conflict between work incentives and some features of the welfare systems is taken into account, to the point that improving the “rewards to work” is not only recommended in a section of the new volume, but is even signaled in the title of one of the two parts of the main text.

The distance from the selection of policies made in the *OECD Jobs Study* is naturally greater and more manifest in proposals made by others. For instance a recent French study due to Pisani-Ferry [13] examines a programme of structural reforms directly concerning the labour market. Even with this limited scope, the author does not mention a number of the OECD detailed recommendations, such as those concerning the employment protection for permanent workers, or the industrial relations in wage bargaining. On the other hand, he stresses the need of reforming the French transfer system, so as to remove the “unemployment traps” and make work pay. Similarly, according to him, fundamental reforms in pension and early-retirement schemes should receive high priority.

3.3 Measuring the Employment Impact of Structural Policies: the Econometric Challenge

When discussions of structural reforms gathered momentum ten years ago, econometricians looked for empirical estimates of the effects on unemployment that would result from changes in such institutional variables as the degree of income compensation granted by unemployment-insurance benefits, or the duration of these benefits, or the level of the legal minimum wage, or an index of the strength of the employment protection legislation, or the degree of centralization in wage negotiations, and so on. In some cases estimates already existed in the literature, although of-

ten concerning only the USA. Many econometricians then decided that the most appropriate source of evidence was given by cross-country comparisons: it could be used fairly systematically; it was also directly demonstrative of what each country could gain by imitating others thanks to specific institutional changes. Econometric analysis of cross-country data was, for instance, the main source of evidence about the effects of structural factors in the well known book published in 1991 by Layard, Nickell and Jackman [5].

Unfortunately, we realize now that the evidence coming from cross-country data is not precise, much less precise than we should like for definite assessments of alternative programmes of structural reforms: estimates of effects are subject to large standard errors, various econometric studies, using different data bases or different specifications of the model used for estimation, sometimes lead to conflicting results. OECD [11] contains an interesting Box 2.3 (p. 55) on the available evidence so obtained. The tone of the text is correct when it writes: «With regard to employment protection legislation, empirical results are somewhat mixed» – or – «Very generous unemployment benefit systems... especially maximum duration may contribute to structural unemployment». Well, “very generous”, “may contribute”: this is not a strong assertion. Indeed, very often the verdict of the econometric work reported in this econometric literature is: “not statistically significant”. This is so much so that different economists, or different institutions, can draw different conclusions from the same body of evidence.

Faced with the lack of accuracy of the econometric results so obtained we must, first, look at results coming from other kinds of evidence: aggregate time-series, panel data, microdata from surveys of households or firms, direct evaluation of the impact of individual labour market programmes, etc. For instance there is now a large body of available results about the employment effect of the level of a legal minimum wage. From this body we can draw the conclusion that, as long as this level does not become fairly high with respect to the medium wage, changes in the level do not seem to have a substantial effect on aggregate

employment. In the third part of this talk I shall refer to other cases in which unambiguous conclusions can similarly be drawn from the data.

Second, lack of accuracy of results obtained from the data does not mean that these results ought to be neglected when they bear on an important issue. For instance, concerning again the minimum wage, available econometric results support the following conclusion: «high levels of minimum wages, relative to medium wages, will probably substantially depress the demand for unskilled labour if they are not somehow compensated in labour costs». Placing the adverb “probably” in the conclusions drawn from econometric evidence permits us to be less rigid about levels of statistical significance: we need hardly more than establishing that negative effects are more likely than positive effects. Such a probabilistic empirical conclusion is worth knowing, particularly when it agrees with the prediction of microeconomic theory. It then supports the premiss that the simplifications and abstractions of this theory are not damaging the real truth of the conclusion in the case at issue. The economist has, all the more so, a duty to report what he or she finds.

4. - A Brief Analysis of a Few Structural Policies

I spent a good deal of my time during the last three decades thinking on how to integrate the labour market into macroeconomic analysis, but I am not a labour economist. This means that I cannot claim to be competent about the analysis of many specific structural policies. I have therefore to be selective in this last part of my talk. On the other hand, I must not be so selective that I would completely ignore major parts of comprehensive programmes of structural reform. These considerations lead me to select the four following targets among those that can be assigned to the structural policies concerning us here: boost employment of the unskilled, make work pay, support the unemployed, make wages less rigid. Within each one of the following four sections I shall moreover be selective in my presentation.

4.1 *Boost Employment of the Unskilled*

Here I am accepting the diagnosis that in our countries excess supply will long prevail on the market for unskilled labour. This diagnosis is not unanimously accepted. So, I must be explicit about the two hypotheses on which it lies, namely that most Western European countries will keep sustaining low wages above their market-clearing levels and that the composition of the demand for labour will keep moving along higher skills than the composition of the supply of labour. I shall not develop the argument behind the first hypothesis which is based on our interpretation of what equity requires and on our present difficulties in meeting the second target to be discussed here, namely that work should pay.

The hypothesis of a persistently higher skill composition of the demand for than of the supply of labour, at the preexisting relative wage scales, applied to the past few decades, mainly because of increasing competition from low-wage countries and technological change. It is well substantiated for the US economy (Katz [3]). It certainly applies also to the Western European economy, where manifestation of the phenomenon was however magnified by the handicap of unskilled workers, exposed to competition from skilled workers ready to accept unskilled jobs in an overall depressed market. The trend on the demand side is likely to persist. On the supply side, accelerating the present rate of increase in the average skill looks like an insuperable task, in particular when we take account of the difficulties facing the education of children and teenagers placed in unfavourable family and urban environments.

In order to bring in the long run the skill-level composition of the demand for labour more in line with the skill-level composition of supply, while maintaining preexisting relative earning scales, a rather natural policy was advocated since the early 1990s, namely to lower the rates of taxes and other mandatory contributions on the use of low-wage labour, so as to widen the relative labour-cost scale and to make unskilled labour less costly to employers. The policy was adopted in a number of countries, in France in particular.

A lesson must be drawn from the French experience about this reform in the labour-tax schedule: it was difficult to make people understand, even in government, that the reform was not expected to bring results instantaneously but rather progressively over many years, and that the long-run impact would be all the greater as the change in the schedule would be expected to be more irreversible. This had really to be a structural reform.

Analysis of the long-run impact of such a reform on employment is still today a challenge, because of hesitations about the choice of the appropriate model and about the values to be realistically given to the main parameters of this model. Those who seriously worked on the problem agree in saying that the impact should be quite substantial in countries like France where the cost of unskilled labour is definitely higher than in the USA and in most other Western European countries. But estimations of this substantial impact vary. The fact is not so surprising, because even the concept of the long-run equilibrium of an economy subject to market disequilibria is still vague. It is, however, revealing of disturbing limits in our present knowledge.

4.2 Make Work Pay

Discussing the content of programmes of structural reform I mentioned earlier the present concern for correcting the perverse incentives facing a number of persons who, benefiting from social transfers, would not raise their income if they took jobs available to them because they would so lose entitlement to most of these transfers. The concern is widespread now in OECD countries. It explains for instance the introduction in the USA of the "Earned Income Tax Credit". It seems to me that similar reforms are still more needed in Western Europe because, on our side of the Atlantic, larger proportions of the population are facing such perverse incentives, whereas introduction of employment-conditional tax credits or benefits (also called "in-work benefits") has been more limited thus far.

I know well the French situation where indeed no rise in in-

come was reported in a survey by a third among those who, benefiting from our RMI (“revenu minimum d’insertion”), took a job. A study due to Laroque and Salanié [4] showed that, for 4 millions in France, the net marginal increase in income resulting from taking a job was lower than 10% of the wage to be earned. Of course, we may argue that such evidence concerns only the immediate effect on income and that further increase in earnings may accrue to employed workers in subsequent years. We may also argue that the pecuniary incentives are not necessarily determinant because having a job gives non-pecuniary rewards in self-esteem, social relations and the like. It is, however, hard to believe that institutions responsible for such a large mismatch between pecuniary rewards and the common notion of the just reward to work will not be detrimental in the long run.

A large variety of policies have been and are used in order to mitigate this mismatch³. Grossly simplifying I may distinguish two approaches, one general, the other specific. The general approach consists in designing a tax credit or transfer benefiting all people with low income who are working, and this according to a common schedule applying to all those concerned. In practice there are additional conditions of eligibility, such as in several countries existence of children in the family. But the system is meant to be simple, transparent and to apply broadly.

The specific approach starts from the observation that the perverse incentives are particularly acute for some specific groups which may be said to stand at the margin of the labour market. The approach then aims at designing solutions appropriate to each group. To make work pay soon then becomes just one target among others, whether the solution concerns the transition from school to work for youths, the interest of part-time job for single mothers or the value of a permanent work attachment for low-skilled prime-age workers who are recurrently unemployed.

Drawing attention to such specific groups often suggests weaknesses of the broad in-work benefit systems when they are applied to the case of particular persons. The remark shows the

³ See for instance the section *Improving the Rewards to work*, p. 98-103 in OECD [11].

importance of a serious involvement of labour economists in policy studies, even if the general approach to the problem is chosen. On the other hand the spirit of the general approach should not be forgotten, even in countries where the main focus is on specific solutions. Indeed the piecemeal monitoring of social policies may inadvertently worsen the reward to work, for instance after discordant revisions in the levels or conditions of social benefits and in the minimum wage.

4.3 Support to the Unemployed

Reforms of unemployment benefit systems have been discussed many times over the last two decades, after a previous period during which some extravagant pronouncements against these systems had been heard. This is a case in which the econometric evidence available around 1980, although not perfectly accurate, was *grosso modo* sufficient for policy decisions, a case which shows that econometric scepticism is not always the proper attitude in the analysis of structural policies. Let me briefly recall the substance of the debate and the econometric evidence⁴.

Unemployment insurance makes the situation of being unemployed less unfavourable. As a consequence, it increases the frequency of movements into unemployment, this from employment as well as from outside of the labour force. Similarly, it increases the length of unemployment spells, because unemployed people do not quit the labour force as long as they receive benefits, and because those looking seriously for a job are less financially pressed and therefore somewhat more choosy.

Estimates of these various effects are not precise; but concordant econometric evidences show that none of them is strong. Referring here to a study of Clark and Summers [1] is convenient. The authors used a sample of 75.000 US households giving sufficient information for knowing the labour market transitions of each individual between March and April 1978 and for imputing to him or her the unemployment benefit due conditional on he or she be-

⁴ For a fuller discussion see for instance MALINVAUD E. [6].

coming or remaining unemployed. The program for computing this hypothetical income replacement used information on each state's benefit formula and eligibility rules, as well as information on federal and state tax codes. After estimation of the effects of the benefit system on labour market transitions. Clark and Summers derived an estimate of the aggregate impact of these effects under two scenarios: a complete elimination of unemployment insurance would have resulted in a US unemployment rate equal to 5.35% in 1978 instead of its actual value of 6.00%, the rate of participation of the working-age people in the labour force being 1.1% lower than it actually was; a more acceptable 10% reduction in unemployment benefits would have led to the unemployment rate being 5.92% and the participation rate being 0.1% lower.

Drawing the conclusions of all the evidences now available, including some provided by his own econometric work, Nickell wrote : «Generous levels of unemployment benefit, so long as these are accompanied by pressure on the unemployed to take jobs by, for example, fixing the duration of benefit and providing resources to raise the ability/willingness of the unemployed to take jobs,... do not appear to have serious implications for average levels of unemployment»; however, «generous unemployment benefits that are allowed to run on indefinitely, combined with little or no pressure on the unemployed to obtain work and low levels of active intervention to increase the ability and willingness of the unemployed to work... is associated with high unemployment».

These quotations reveal a trend in the evaluation of structural policies concerning the treatment of the unemployed. Often in the past, discussions concerned the optimal pattern of the unemployment benefit code, assumed to give a right to payment. Those in charge of implementing the policy had just the passive role of checking that conditions of eligibility were met. Much more often today the so-called «active policies» are also stressed, implying pressure on the unemployed as well as non-pecuniary support for finding jobs or upgrading employability⁵.

⁵Actually the phrase «active labour market policies» is often used to designate a larger, and fairly heterogeneous, group of policies containing also subsidies to private-sector employment and direct job creation in the public sector.

For econometricians the role of active policies is still more difficult to estimate than that of passive ones, because econometric investigations are then bedevilled by a number of data and technical difficulties. Fairly reliable results, however, come from evaluations of particular programmes, in countries (mainly the United States and Canada) where such evaluations are available because they are a mandatory requirement on the public authorities in charge of implementing the programmes. For the case concerning us now, evaluation seeks to measure the impact of participation in the programme on individuals' employment and earnings outcomes after they have left the programme, judging the outcomes against the experiences of a control group of similar individuals who did not participate. Martin [8] presents a survey of the conclusions to be drawn from such evaluations.

Programmes of job-search assistance, actually the least costly of labour market programmes, consistently show positive outcomes: investing in active placement, raising the motivation of the unemployed, monitoring their job-search behaviour, pay dividends in terms of getting the unemployed back into work faster.

In contrast, evaluations of public training programmes suggest that their overall record is uncertain, but their record for adult women most often positive. Crucial features in the design of these programmes turn out to be: (i) tight targeting on participants, (ii) keeping the scale of the programme relatively small, (iii) having a strong on-the-job component, hence establishing good links with local employers.

4.4 *Wage Flexibility*

As we saw in section 2.2, recent trends in the views about the appropriate package of structural reforms moved away from the simple and exclusive earlier motto to make labour markets more flexible. The motto was never unanimously endorsed. Recent publications still bear the trace of older oppositions, for instance in the Summer 1997 issue of the *Journal of Economic Perspectives* with the two articles of Siebert and Nickell: the first author does

not hesitate to write under the title *Labor Market Rigidities: at the Root of Unemployment in Europe*, whereas the second article concludes with the following paragraph: «It is clear that the broad-brush analysis that says that European unemployment is high because European markets are “rigid” is too vague and probably misleading. Many labor market institutions that conventionally come under the headings of rigidities have no observable impact on unemployment».

Indeed, thanks to the work of the last decades, we know better now which rigidities are likely to be most detrimental to employment. The discussion of support to the unemployed in the foregoing section well illustrates this point. But even on favourable cases our knowledge is not perfect. *A fortiori* a good deal of variation exists between the declarations of those who, having worked on the structural prerequisites of full employment, formulated lists of these prerequisites⁶. Rather than adding my own list here, which would not really serve the reader, I shall limit my comments to wage flexibility.

Nobody now seriously pretends that wage rates should be fully flexible, in the sense of varying in such a way as to lead to continuous clearing of all labour markets. This would amount to deny that employment contracts should normally be concluded for durable attachment and that employees should be paid just wages. Incidentally, this would also amount to forget what Keynes wrote about the destabilizing effect of wage flexibility in its extreme form. The phrase “wage flexibility” as commonly used does not mean this extreme market-clearing form. It really hints that actual institutions lead to too little reaction of wage rates to labour market disequilibria. It makes sense mainly with respect to either the overall level of real wages in the country or to relative wage rates of various groups of employees. Let me take these two aspects in turn.

Economic history shows that, at the aggregate level in mar-

⁶ For evidence about the variety of opinions see the following references here: ELMESKOV J. *et AL.* [2], LAYARD R. *et AL.* [5], NICKELL S. [9], OECD [11], PISANI - FERRY J. [15], SIEBERT H. [14].

ket economies, trends of real wages were normally roughly in line with what was required. But sometimes they drifted in such a way as to seriously damage business profitability, then leading to depression and unemployment. This was the case with the “wage gap” in Western Europe during about a decade around 1980. The idea naturally came to mind that something had then gone wrong in the institutions ruling collective wage bargaining. This was remedied in some countries by consultations at the national level and by wage-restraint agreements. This also led some economists to recommend structural policies aiming at permanently changing wage bargaining institutions, either by reducing the power of labour unions or by forcing a better coordination in wage negotiations.

I wonder whether structural reforms of that type are really to be aimed at for the purpose of insuring that wage gaps will be avoided in the future. What happened in our countries twenty years ago was special in various ways. I claimed in the first part of my talk that the correct approach to deal with similar situations was to think in terms of macroeconomic policies rather than structural policies, which could only indirectly, hence less efficiently, address the problems raised by abnormal trends in real wages. Moreover, how to implement in practice changes in wage-bargaining institutions is often not clear. Finally, the econometric literature about the effect of centralization and/or coordination in wage negotiations does not seem really conclusive, in particular because of a possible bias in cross-country evidence, due to the role of deliberate policies of wage restraint in some countries in the early 1980s.

In this respect OECD [10] is somewhat ambiguous. On the one hand, the summary of the recommendation about wage flexibility writes: «Makes wage and labour costs more flexible by removing restrictions that prevent wages from reflecting local conditions and individual skill levels, in particular of younger workers». This refers only to relative wage flexibility. On the other hand, the details of the recommendation show more general interest in wage bargaining reforms which would increase the freedom of employers or relax the administrative extension of wage

agreements between unions and employers. OECD [11] shows that this interest in reforms of industrial relations did not disappear.

The case of some relative wage rigidities is less debatable. What I presented in section 3.1 about the employment of unskilled labour is directly relevant and needs no repeating. Also quite important in some countries is the excessively high level of wages in regions where labour productivity is low. Linked with low inter-regional migrations, the fact is responsible for high unemployment in those regions. The Mezzogiorno is the best example we can give of the phenomenon, although the Eastern German Länder may soon become a still more striking case.

I have no competence for explaining here the continuous existence of excessively high wages in low productivity areas, *a fortiori* for discussing appropriate structural policies which would solve the problem. I can just refer here to an article of Padoa Schioppa Kostoris [12] who has a section entitled: *The Regional Distribution of Italian Unemployment and the Effectiveness of Diagnoses and Therapies Proposed for European Unemployment* where she wonders about the implications to be drawn for the Mezzogiorno from the diagnoses and cures which are more generally proposed, for instance by OECD. She notes that the negative consequences of labour market rigidities are particularly felt in the Mezzogiorno: «Being unable to overcome [these rigidities] with higher productivity, innovative capacity and technical progress, [the region is] compelled to endure them, giving rise to unemployment or underground employment». She argues: «The approximately complete wage homogeneity between the North-Centre and the South [of Italy] associated to a wide productivity gap between the two areas... strongly hinders a recovery of the labour market equilibrium in the South... Over the past 30 years, a misled equalitarian approach has brought about unequal opportunities... It is both unfair and inefficient to impose the same economic and legal labour-market regulations to the North-Centre and to the South, particularly but not exclusively in the public sector».

* * *

In order to conclude after the brief comments I made on too many points, I purpose to now look at our subject from a distance, accepting to still more relax at this point the concern for scientific accuracy so as to come closer to the philosophy of decision makers. Conclusions are simple: we must act notwithstanding uncertainties; we must act with determination.

Employment is important in our rich countries, much more important than levels of living. Employment in one or two decades from now is important, much more important than the current trend of statistical series and the voice of pressure groups before the next election. High rigidities are probably detrimental to employment in the medium and the long run. Given the stakes and what we know about the likely trade-offs, we should now reduce somewhat market rigidities, in the same way as, given the stakes about the environment and what we know about the likely environmental trade-offs, we should now reduce somewhat CO² emissions.

Borrowing the spirit of the conclusion of Elmeskov, Martin and Scarpetta [2], I shall moreover endorse in this philosophical conclusion an idea that they develop in their interesting article. Let us opt «for a comprehensive set of structural reforms and exploit the synergies between these reforms and macroeconomic policies ... It requires strong political will and leadership to convince electorates that it is necessary to swallow... the medicine, and that it will take time before this treatment leads to improved labour market performance and falling unemployment. But the success stories show that it can be done».

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