

# **Will ‘structural reforms’ of labour markets help the unemployed?**

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## **From the neoclassical diagnosis of Unemployment ...**

**Unemployment is caused by rigidities that prevent the labour market to work as a real market:**

**Rigidities such as Collective Wage Agreements, high minimum wages and high social benefits make wages rigid in downward direction → Wages cannot adapt to economic shocks → unemployment**

**... to the plea for ‘structural reforms’ of labour markets**

# Intentions behind ‘structural reforms’ of labour markets:

## Explicit intentions:

- **Make firing easier**
- **Reduce minimum wages**
- **Reduce social benefits**



**Realize downward  
wage flexibility!**

## Implicit intentions:

- **Reduce trade union power**
- **A more **unequal** income distribution**

## **The overall aim of ‘structural reforms’:**

**No ‘full employment’, but ‘natural’ rates of unemployment that are high enough to guarantee sufficient competition for scarce jobs**



**It's all about power relations and income distribution!**

**Ever heard of **NAIRU**?**

**The **N**on-**A**ccelerating **I**nflation **R**ate of **U**nemployment ...**

**A thorough criticism of NAIRU:**

Storm & Naastepad: *Macroeconomics beyond the NAIRU*,  
Harvard University Press, 2012.

## **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 ('Japanese scenario')**

(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 chance of jobless/job poor growth, thanks to the IT revolution**

(see: E. Brynjolfsson & A. McAfee: *The second machine age*, New York: Norton 2014).

## **Conclusion:**

**It is unlikely that, in the nearer future, high GDP growth will reduce unemployment in the Eurozone, notably in Southern Europe**

**Persistently high unemployment is destructive to solidarity and will erode the European Social Model:**

- **Weaker trade unions**
- **Pressure on wages and social standards;**
- **Easier firing and more ‘flexible’ labour markets through ‘structural reforms’**

## **My diagnosis of unemployment in Europe:**

- It has little to do with ‘lack of competitiveness’ or with outsourcing to low-wage countries and
- It can hardly be reduced through more aggressive export strategies

### **Note:**

**The *Coordinated Market Economies* (CME) of ‘Old Europe’ (and the Eurozone) tend to have export surpluses.**

***Liberal Market Economies* (LME) in Anglo-Saxon countries tend to have import surpluses.**

**Why then high unemployment?**

## **Why is European unemployment so high?**

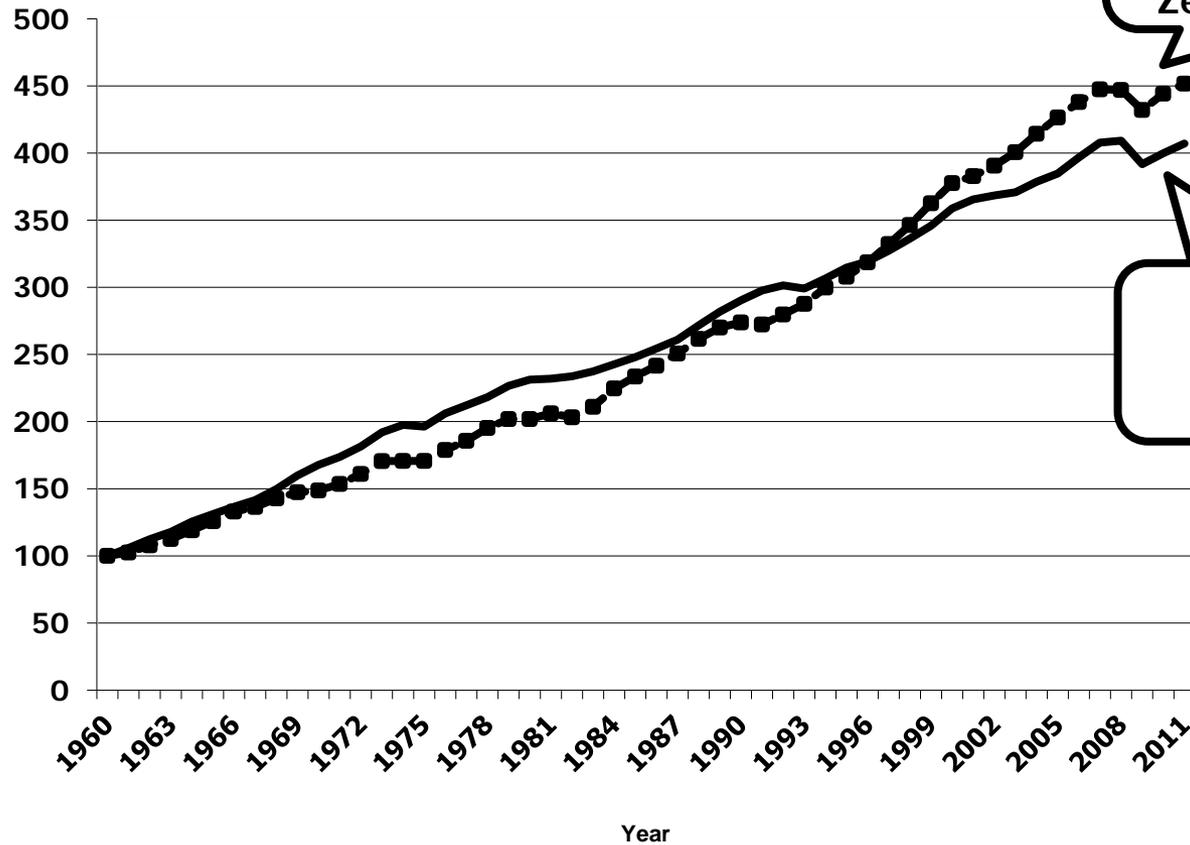
***Coordinated Market Economies (CME)* have substantially higher growth rates of labor productivity than *Liberalized Market Economies (LME)* ...**

**... in other words, growth of GDP/labor hour tends to be equal/higher than growth of GDP → you need less labor hours**

**... and, as a consequence, CMEs have a lower growth of labor input than LMEs!**

# In the long run: there is little difference in GDP growth ...

**Development of real GDP,  
1960-2004; 1960 = 100**

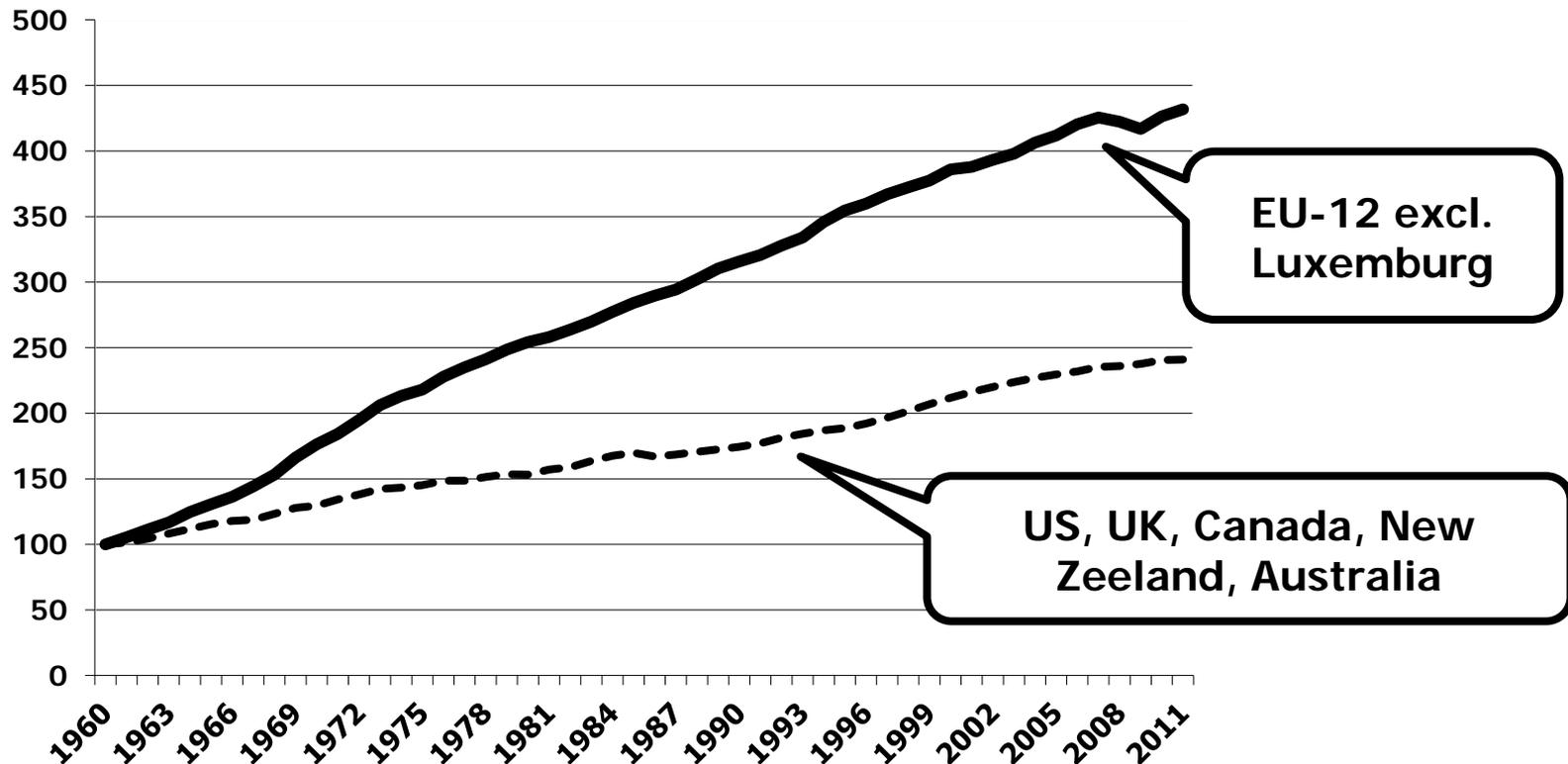


Anglo-Saxon  
countries: US, UK,  
Canada, New  
Zealand, Australia

EU-12 excl.  
Luxemburg

... but GDP/working hour is growing faster in *Old Europe*

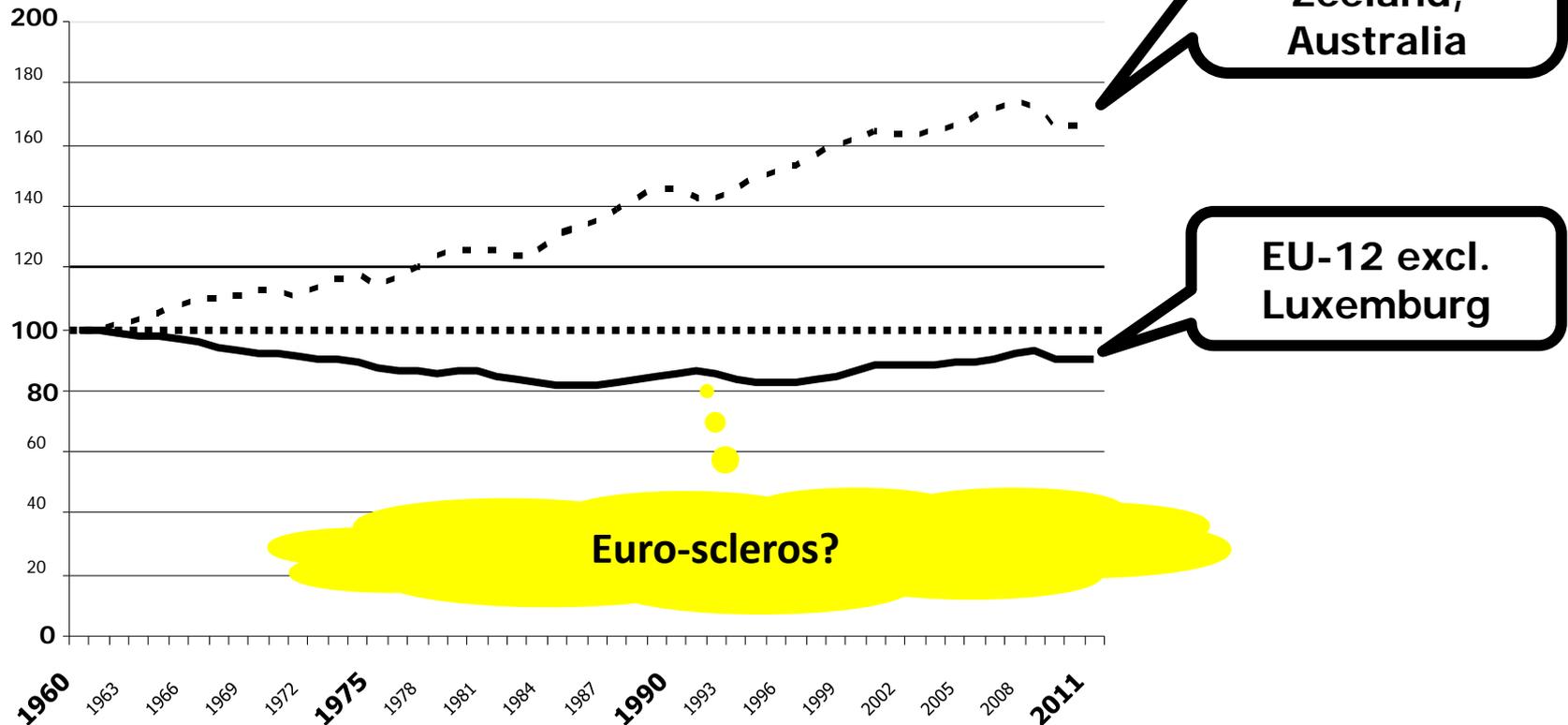
Development of labor productivity,  
1960-2004; 1960 = 100



Labor productivity = GDP per working hour

... and this results in job-poor growth in Europe and job-rich growth in Anglo-Saxon countries ...

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



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### Explanations?

- Speed of adoption of labour-saving / productivity-enhancing technology (Substitution of capital for labour)
- Vintage effects
- “Creative destruction”

**Panel data estimates (20 OECD countries; 44 years) show:**

**A one-percent lower (higher) wage growth leads to an  $\approx 0.4\%$  lower (higher) growth of labor productivity**

Source: Vergeer, & Kleinknecht (2014): Does labor market deregulation reduce labor productivity growth? *International Labour Review*, Vol. 153(3), p. 365-393.

**Evidence at *macro-level* is consistent with findings from *firm-level* studies:**

**Anglo-Saxon type work practices reduce wage costs but are negatively related to:**

- **Labour productivity growth**
- **The probability to innovate**

**... and they enhance the growth of management bureaucracies for monitoring & control**

Recent paper: Kleinknecht, van Schaik & Zhou (2014): 'Is flexible labour good for innovation?', in *Cambridge Journal of Economics*, Vol. 38(5): 1207-1219.

# **Why are CMEs outperforming LMEs in labor productivity growth? (1)**

**Deregulation of labor markets leads to ‘more dynamism’, i.e. higher job turnover, which in turn reduces loyalty and commitment of workers:**

**→ more leaking of trade secrets and technological knowledge**

**→ more need for monitoring & control and thicker management bureaucracies**

## **Why are the CMEs outperforming LMEs in labor productivity growth? (2)**

**Deregulation of labor markets and higher job turnover lead 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!**

Empirical support using patent data:

Acharya et al. (2010): *Labor laws and innovation*, NBER Working Paper 16484. Cambridge, MA: NBER

## **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 ‘Creative Accumulation’ innovation model requires a continuous accumulation of (often: **tacit**) knowledge → need for continuity of personnel**

**Tacit knowledge** = poorly documented, ill-codified knowledge from experience

## Rounding up (1):

### Two alternative strategies for capitalism:

**Supply-side economics:** Through 'Structural Reforms' to flexible labor markets: easy firing + poor welfare state:

- Overall poor labor productivity growth → many precarious jobs!
- A much more unequal income distribution

**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:
- *Poor* overall growth of labor input, and therefore ...
- Shorter working times rather than wage claims → Reduce labor supply

## **Rounding up (2):**

# **What to do about unemployment?**

### **1. Given:**

- a) the high potential of labor-saving IT,**
- b) the probability of a longer period of poor GDP growth, and**
- c) ecological constraints,**

**shorter standard working times are unavoidable**

- ### **2. Create a framework for (legally limited) monetary financing of extra government expenditures (e.g. to be allowed only at inflation rates of <2%)**

## **Rounding up (3):**

### **What to do about unemployment?**

#### **3. Offer those who qualify as ‘long-term unemployed’ a job in local communities at the minimum wage**

See: Mitchell, W.F. & J. Muysken (2010): ‘Full employment abandoned: Shifting sands and policy failures’, in: *International Journal of Public Policy*, Vol. 5(4), p. 295-313.

#### **4. More European solidarity: e.g. a European unemployment insurance**

## **Rounding up (3):**

### **What to do about unemployment?**

- 6. Make an end to the German (and Dutch) *beggar-thy-neighbor* export policy, for example through:**
  - **Germany taking a 3% budget deficit.**
  - **Trade unions doing something about too low wage unit costs in Germany and in the Netherlands**