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# Comment on Gilles Saint-Paul: The political consequences of unemployment

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The starting point of Gilles Saint-Paul's paper is the belief among most economists that the high and persistent unemployment in most European countries is caused by the rigidities imposed on the labour market by governments and/or trade unions. According to this model, minimum wages, unemployment insurance schemes, various forms of active labour market policies, laws regulating work safety, most forms of collective bargaining, and other measures that infringe upon the possibilities to form individual labour contracts, are causing inflexibility. This inflexibility prevents the labour market to function as a proper market, such as the spot markets for oil or grain. Like all other markets without such democratically decided regulations, the labour market should "clear" at the wage where demand meets supply. Only search unemployment would then exist, i.e., unemployment caused by transaction costs arising for the time that it takes to search out and close individual contracts.

This idea is not very new, and the difficulties of implementing such a labour market in the real world are well-known. In 1907, Hjalmar von Sydow, the chairman of the Swedish Employers' Federation, made the following statement when commenting on a proposal to introduce so-called labour bureaux (i.e., employment exchanges run by the employers' organisations) so as to sort out (rent-seeking!) union activists, break strikes, and in other ways increase the flexibility in the Swedish labour market:

> The great power which this system places in the hands of the labour bureau raises misgivings, nor can it be denied that there is something repugnant in the way in which the workers are at the disposal of the system, to be moved about like pieces on a chessboard. Moreover, the introduction of such a labour exchange would no doubt encounter determined resistance from the labour organisations, and probably could not be undertaken except at the end of a general labour dispute in which the workers had been completely defeated (quoted from Rothstein, 1996).

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This is but one example why historically, it has been the exception rather than the rule to establish labour markets that function according to the standard market model. Another reason is that wages tend to be "sticky" downwards. However, for a political scientist like myself, it is difficult to argue against the sheer theoretical elegance of the standard market model. There is also quite some empirical evidence that this model is a good approximation of how some real-world labour markets work. Especially when we compare the unregulated labour market in the US with the more regulated ones in Europe, one is struck by the impressive capacity of the former to create new jobs in the way the standard model predicts.

But for the sake of the argument, I would like to put in a few question marks. One is that what is left out from these comparisons is the difference in the number of people in prison. Today, the US has about 640 prisoners per 100,000 citizens. The comparative figure for the large European countries is 70-80, for Sweden it is around 40 (Wacquant, 1998). For the US, this means that about 2% of the workforce is in prison—a figure that one could argue should be added to the unemployment rate in the US. Second, while crime may have many sociological and psychological causes, pure economic ones could not be ruled out. My argument is that this dramatic difference in the number of prisoners between the US and e.g., Sweden can very well be caused by the much cherished flexibility of the American labour market. For that part of the population, which will have to respond to the downward flexibility of wages, crime can be seen as a "rational" option. The transaction costs for the law-abiding citizens living in a society with high crime rates should maybe also be considered (Becker and Landes, 1974).

A second argument is that according to one study, the US labour market is not the most job-creating labour market in the OECD. It is surpassed, at least during 1980s, by the labour markets in Canada and Australia, which are more regulated and rigid than the labour market in the US. So it may be something else, or more than just regulations and labour laws that cause unemployment (Faux, 1994).

A third point is that in the discussion about the negative impact of regulating institutions, many economists tend to conflate two different types of institutions. I think it is useful to distinguish between two different types of institutions that regulate markets, namely redistributive and efficient institutions (Tsebelis 1990). While the former may indeed have negative welfare effects, the latter can be understood as institutions that are established to solve collective action problems. Without such "efficient" institutions, actors are, according to non-cooperative game-theory, very likely to get caught in pathological "social traps" (Miller, 1992). While it is empirically not always easy to decide if an institution belongs to the one category or the other, it is very useful to make such an analytical distinction. A well functioning labour court, which can solve disputes over how to interpret contracts, can on the one hand be thought of as an institution that creates inflexibility by encouraging collective bargaining. On the other hand, without such a labour court, unions and employers may end up in ongoing and extremely costly disputes over the interpretation of contracts, i.e., in "social traps".

Lastly, as have been argued recently by Agell (1998), it may very well be that it is not regulations and labour laws that create labour-market rigidities in Europe, but instead, deep ingrained cultural norms about fairness and equality. The rationality of such norms can of course be debated, but according to Agell and others, they have clear empirical support from both field studies and experiments (Miller, 1992; Lichbach, 1995; Agell, 1998). So the standard policy prescription to deregulate and to abandon collective bargaining may have little impact in the European countries.

Nevertheless, for the rest of this comment, I accept Gilles Saint-Paul's point of departure and try to discuss his arguments from his own perspective. The first main argument is that when unemployment is high, national unions will have a stronger incentive to opt for industrial disputes because the possible rents from such conflicts are higher. While I except the logic of the model, I think there are at least three countervailing tendencies that are left out. One is that while the economic incentive to opt for conflicts may be higher when unemployment is high, so is the potential risk that union leaders face. As seen from, e.g., the mining conflict in the UK in the early 1980s, the risk that unions will be severely damaged by such conflicts is high. It seems strange to omit this risk factor from the incentive structure of union leaders. As Golden (1996) showed, the reason why unions opt for a conflictual strategy, when unemployment is high, is likely to have causes that are very different from those that Saint-Paul stresses.

Second, the empirical evidence presented is, as the author himself admits, not very compelling. One reason for this may be that the incentive by national unions to opt for conflicts is balanced by the fact that local unions should, according to the model, be less conflict oriented. Often, national unions can do very little if they do not have strong support from local unions. I find it strange that this effect of local unions is not incorporated in the model.

Third, the model seems to omit the well-established result by Calmfors and Driffill (1988)—that some forms of national union wage co-ordination can serve as a way to actually make the labour market work more like the standard market model. If the unions are broadly organised and/or can co-ordinate on a high enough level, the possible gains from rent seeking will be much smaller.

The second main argument in the paper is that the higher the rent that employees get, the more likely they are to use whatever political power they have to protect this rent. Let me say that this is not a very surprising result, and that the elaborated equations are totally unnecessary to prove this. It would suffice with standard utility theory to say that the more you value something, the more likely are you to try and protect this something. Workers, who know that they can easily find new jobs if they are fired, would not use much time and energy to protect their old jobs.

From a Swedish perspective, the real puzzle is why the Swedish union movement, which is among the strongest in the world, has done so little to protect jobs in non-profitable industries. According to Saint-Paul's theory, the famous Rehn-Meidner model, which pushed for strong union support for industrial rationalisation, should never have seen the light of day. Nor is it consistent with the theory that the Danish labour movement has done so little in the way of job protection. It is not empirically correct to state that "employment protection prevails in Europe". The picture is much more complex. There is also ample evidence that what we have seen in Europe since 1985 is a reduction in most countries of the numbers of public employees. Again, this should not have happened according to Saint-Paul's model when unemployment has been on this rise. A recent paper even shows that between 1950 and 1990, the number of public employees in the US grew more than in Germany (Derlien and Peters, 1998). The measure used by Saint-Paul to prove his point is government expenditure, but that is something very different from measuring government employees. Again, the empirical evidence is far from compelling.

The last main argument in the paper is that there should be a positive correlation between high government spending and high unemployment. To my mind, this is the least convincing of the three arguments put forward. First, one is surprised to read that countries such as Sweden and Finland are characterised by "centralised wage setting agreements and other co-ordination devices that prevent unemployment from rising" (Section 3). This was many years ago, I would say. Second, from what I know about the Danish labour market, it is wrong to put Denmark in the group with rigid institutions. Danish workers have hardly any legal or other equivalent means to protect them from being laid off. Third, no convincing argument is present for why a regulated labour market should go hand in hand with preferences for high government spending. Fourth, there is now ample evidence that the idea that high taxes cause economic decline does not hold ground. Most studies on the micro level show that the substitution and income effects of income taxes largely offset each other. In plain language, if you lower marginal taxes, some people will work more because it pays more to work. But some people will work less, because to earn as much money as they want, they can work less. Looking at macro evidence from cross-country comparisons the evidence that public expenditure harms growth is simply not there.

In conclusion, I have found this paper wanting on many respects. But I do think that there is one very promising idea that should be developed, and that is the implicit reasoning about what in political science has become known as "lock-in" or "policy feed-back" effects (Pierson, 1994; Rothstein, 1998). Social scientists and economists usually think that public policies are ultimately caused by societal factors (social values, cultural norms, economic interests, the power of social classes, etc.). The idea behind "policy feed-back" effects is very different, namely that once a policy is institutionalised it will produce a feedback mechanism into the political process, thus producing a causal logic of its own. In some cases, this may result in situations where public policies are "locked in", i.e., they create the electoral and political support needed for their preservation.

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