EMU and Asymmetries in Labour Markets

Asymmetric shocks represent a key problem for EMU. However, symmetric shocks can also have asymmetric effects if economic structures are asymmetric. There are mainly two fields where this phenomenon is crucial: the transmission channels of the monetary policy, and the wage setting mechanisms. This workshop dealt with the latter.

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Summary of the Proceedings

Existing Existing Asymmetries Between European Labour Markets

David Mayes (Bank of Finland) presented a paper written with Matti Viren on the existing asymmetries in the Euro area and the problems of aggregation they raise for policy makers. Many kinds of asymmetries were identified: the first kind deals with economic variables (output per head, inflation, unemployment, specialisation patterns); others include different coefficients of variables in functions (elasticities), different relations between economic variables and different policy responses. These asymmetries increase the probability of asymmetric shocks; however, even symmetric shocks could entail asymmetric answers given the differences in reactions to shocks. For example, the authors showed that there are considerable asymmetries in the various regional, sectoral and national IS, Phillips and Okun curves. In addition, many non-linearities appear in key economic relationships (business cycles, Phillips and Okun curves). Hence, the reaction of the various economies to the same shock depend on their respective positions in the business cycle. Policy makers have to take into account these facts if they want to avoid taking wrong decisions: for example, if you want to lower unemployment or inflation, you have to consider the "marginal" region and not make a misleading means. The ECB should therefore orientate its policy at the tightest labour market and not at an average value.
David Bendor (UK embassy) asked if a break sign in asymmetries had been detected with the introduction of the European single currency. David Mayes explained that the data was very coherent from 1987 up to now.
Eric Pentecost (Loughborough Univ.) presented a paper written with John Sessions on the determinants of labour market flexibility in the EU. They too found, using a time-varying methodology, that there are differences in Phillips curves across the main European Union member states. The differences in sacrifice ratios (the slope of the Phillips curve, identifiable as a proxy of market labour flexibility) can partly be explained by different institutional settings: openness and productivity of labour are important determinants, whereas unemployment benefits, strikes, unionisation and social protection do not seem important. The impact of the pursuit of integration in the Euro zone was rather ambiguous as different determinants were affected differently.

In the discussion, Richard Nahuis (CPB) asked for including the Central Bank policy into the Phillip's curve. Wolfgang Scheremet (DIW) stressed that the openness variable was biased by the size of the country, as small countries are de facto more open than larger countries. For Agnès. Bénassy-Quéré (CEPII), the methodology applied better to price acceleration than to inflation.

Jean-Pierre Laffargue presented a paper written with Stéphanie Guichard on private wage behaviour in industrialised countries. Using a panel methodology, the authors show that the main difference across countries is the reaction of the wage rate to changes in productivity and in the employment rate, the latter being a better indicator of labour market tensions than the unemployment rate. Additionally some evidence was found of nominal rigidity in wage behaviour and of a small effect of the fiscal wedge. Finland and Spain had negative and significant coefficients for the employment rate which could be explained in the case of Finland by the strong economic recession at the beginning of the 90's and in the case of Spain by the great rigidity and the deep duality between fixed term contracts and undetermined contracts.

Ruud De Mooij (CPB) said that unemployment benefits should have been taken into account; the author argued they could not find a satisfactory indicator reflecting at the same time the benefits, their duration and their degressive character. Ruud Okker (CPB) asked if direct and indirect taxation had different effects: however, the progressivity of the income tax made it impossible for the authors to incorporate it in their study.

General Discussion

Lionel Fontagné raised some questions: was it possible to group countries by their level of asymmetry to some EU standard (North versus South, Euro versus non Euro area)? Had a break in labour market situations been observed over time? What were the implications of asymmetries for policy making?

David Mayes did not identify this division between Euro and Non-Euro zone. Instead, he distinguished four types of labour market institutional settings: Nordic, Anglo-Saxon, continental and southern countries. Beyond the regional division, the size of the country was important for its reaction to shocks. Agnès Benassy-Quéré cited a study from CEPII where no simple relationship between labour market institutions and its flexibility was identified and where different labour market structures did not necessarily lead to asymmetries after symmetric shocks. As far as the integration of labour market in Europe is concerned, Wolfgang Scheremet attributed a stronger importance to the accomplishing of the single market than to the EMU. Pierre Morin (INSEE) noticed important similarities in the labour market structure by comparing the coefficients of the core countries of the EU (except Germany) in the paper presented by Jean-Pierre Laffargue. He concluded that there might be the sign of a long term harmonisation of labour market structures in the EU. Eric Pentecost noted that regional disparities up to the nineties have been stronger than national ones.

Breaks in time series were difficult to see, especially in the wage formation process. However, Phillips curves and wage shares appeared to have evolved.

Lionel Fontagné asked how to react with a common monetary policy to the strong growth and inflation observed in Ireland. The economic growth in Ireland, in the view of David Mayes, is due to important structural changes in the years before: the consequences of these changes emerge only today but are a problem for the common monetary policy.

At the national level fiscal and wage policies can compensate possible asymmetric consequences of monetary policy. However, Nicola Viegi (Strathclyde Univ.) doubted such instruments would be sufficient (especially with low factor mobility and in the absence of real transfers between states). Possibility of higher adjustment costs after Euro was also discussed.

The Evolution of Wage Setting Mechanisms Following the Introduction of the Euro

Karen Dury (NIESR) presented a paper written with Ray Barrell on the potential impact of asymmetries in labour markets in Europe on the design of policy rules. Despite acknowledging differences between European countries in structures of labour demand, in wage bargaining process and in speeds of response to shocks, the authors concluded that those differences appear to have little influence on the optimal setting of monetary policy of the ECB. Using different models of Europe (imposition of commonalty for none, some or all of labour market relationships), the authors found the preferred rule for the ECB stayed a combined nominal aggregate and inflation targeting rule.

Agnès Benassy stressed the inflation target rule was the only rule which could effectively be implemented by the central bank.

Alain Borghijs (Antwerp Univ.) presented a paper on the impact of EMU on wage-setting mechanisms. Economic integration and product market integration may increase the incentives for trade unions to co-operate. But there are arguments against the "Europeanisation" of wage formation, which stem from a risk of higher wage demands in a large, relatively closed economy such as the EU and from a decrease in the possibility for wage policy to adjust for asymmetric shocks. However the author showed that EMU did not always increase the incentives for trade union co-operation; moreover, the claim that wages would react less responsively when set jointly is no more supported by the model; however, trade union co-operation results in higher wages.

Participants stressed that tighter competition and increased facility to relocate activities could affect incentives for union co-operation. This was however more a feature of the internal market than of EMU: in the latter, transaction costs had not evolved. Ruud de Mooij wondered if considering other types of union centralisation would lead to different results.

Wolfgang Scheremet (DIW) presented a paper on the convergence of wage policy after EMU. Using both econometric tests and analyses of wage setting institutions, the author underlined that wage policy was still very heterogeneous in Europe. The convergence of inflation rates implied in that light the continuation of regional differences in unemployment rates. Only a few countries show a structural break in their wage formation process since 1970. As such convergence of wage policy after EMU do not seem so evident.

Jorgen Mortensen (CEPS) considered productivity increases not to be exogenous: Germany is a counter example where higher wages later lead to productivity increases.

Steven Tanguy (Rennes Univ.) presented a paper on the degree of co-ordination between national trade unions. Economic integration has an ambiguous impact on wage formation: the downwards mechanical slip in the scale of the centralisation of negotiations could increase wages, but the intensification of international competition should discipline trade unions. According to the author, wage bargaining co-ordination leads to wage moderation when the economies are hit by shocks. The main reason for this result is the possibility to take into account global negative externalities at a European level.

Andreas Breitenfellner (Bank of Austria) asked if the source of the shocks did not interfere with the results: unexpected and government policy induced shocks could prevent wage co-ordination from eliminating asymmetries

General Discussion

First methodological issues were discussed: temporary shocks can have permanent and diverging effects if wage curves are used; conversely, the use of Phillips curves lead to temporary effects. The determination of stochastic shocks was also discussed, with possible breaks in the relationships making some problems.

Secondly, the evolution of unions wage bargaining power after the introduction of Euro seemed uncertain: the Euro-zone is indeed less open than its constituents if openness is defined by the ratio of trade to GDP; however, the degree of competition increased in the zone, both in and between countries. Another point noted was that the multiplication of agents in an international setting makes co-operation harder.
Alain Borghijs wondered if asymmetric productivity shocks could not be caused by high regional specialisation within Europe and if EMU would not be in that case a factor of instability. However, Lionel Fontagné argued that EMU would diminish specialisation and attributed asymmetric shocks to different stages in the business cycle.

Labour Asymmetries and the Conduct of Monetary Policy in EMU

Nicola Viegi (Strathclyde Univ.) presented a paper written with Andrew Hughes Hallett on the importance of asymmetries in labour market institutions in the operation of a monetary union. The authors acknowledge the importance of asymmetries in preferences or in shocks, but in their mind, the main problem caused by asymmetries stems from differences in market structures and institutions. Countries with flexible (i.e. decentralised) labour markets do not wish to join an union of economies with less flexible (i.e. more centralised) markets. However, at the same time, the less flexible prefer only the more flexible to join. In addition, once countries have joined, there is little incentive to make markets more flexible: the opposite even applies as centralised wage policy can be used as en extra policy instrument to react to specific shocks.
A. Benassy-Quéré raised the concern of negative economic consequences if the government and the trade union had differing targets.
Kari Alho (ETLA) presented a paper on the Finnish experience: the Finnish EMU buffer funds' goal is to maintain the social security contributions of employers during a possible recession in the EMU. However, their capacity to act as a stabilisation tool must not be overvalued and they may even lull participants to postpone necessary reforms. According to the author, to maintain employment during a recession, cuts in indirect labour costs, even at the cost of social security benefits, may yield better results.
The discussants doubted of the advantages of the Finnish approach to stabilise employment. A conventional pay as you go system, which is not implemented in Finland, would offer less unemployment at the long run.
Richard Nahuis (CPB) presented a paper written with Ashok Parikh on the role of labour mobility and flexibility as an adjustment tool. Labour mobility can play a role in resolving regional disparities and absorbing shocks, especially in the absence of fiscal redistribution. However it seems low in Europe relatively to the US, and seems to stay low despite regional disparities. This result can partly be explained through the adjustment in participation rates, especially female participation. Part time employment does not play an analogous role.
Agnès Benassy-Quéré doubted the negative correlation between female participation in a country and migration rates. Furthermore regional migration seemed more important than international migration.

The discussion focused on the necessity to distinguish between trade union co-ordination between countries and national wage bargaining centralisation level. Confusion between the two was often the source of diverging results (especially as there seem to be different ways to achieve wage setting flexibility). Both influence the capacity of wage policy to act as a partial substitute for exchange rate policy.

The extent to which EMU would affect wage setting mechanisms was seen uncertain. On the one hand, the co-existence of asymmetric markets seems possible, given the limited convergence in Europe and the persistence of regional asymmetries. On the other hand, real convergence may become necessary. Jorgen Mortensen stressed the importance of regional studies to better assess forthcoming effects.

Those asymmetries did not seem to have much impact on the conduct of monetary policy, but were considered to make accession more difficult.