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## Macroeconomic Shock and Labour Market Programmes

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### Abstract

The paper presents a theoretical analysis of macroeconomic effects of employment subsidy programmes and training/education programmes when the economy faces a macroeconomic shock. Wages and employment are determined by the intersection of demand curves and wage-setting schedules. The wage curve is derived from the Shapiro-Stiglitz efficiency-wage model. Employment subsidy programmes decrease the risk of being unemployed and tend to keep the welfare of workers. Training programmes upgrade labour skill and tend to transfer labour from a low-productivity to a high-productivity sector. Both programmes tend to increase the welfare of workers. However, the macroeconomic impacts of these two programmes on wages and labour productivity are different. The paper investigates and compares the macroeconomic influences of subsidised employment programmes and training/education programmes in a dual labour-market framework.

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*Keywords:* Macroeconomic shock; training/education programmes; employment subsidy programmes; productivity; unemployment

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### 1. Introduction

The expenditure for employment subsidy programmes in Japan has increased dramatically since the collapse of the venerable American investment bank, Lehman Brothers, in 2008. The expenditure for employment maintenance programmes in 2008 was 6.8 billion yen, but it became 654 billion yen in 2009 and

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3250 billion yen in 2010. Those programmes covered 1.8 million workers per month in 2009 and 0.85 million workers per month in 2010 (Ministry of Health, Labour and Welfare, 2011). These numbers correspond to 2.8% and 1.3% of total labour force in each year, respectively. Because of the employment maintenance programmes, a lot of workers avoid the risk of being unemployed. The employment maintenance programmes are good for employers, too. If firms can keep workers as stand-by workers instead of firing them when the economy is in a recession, firms can be back in business quickly with low costs when the economy recovers. It is also good to society that workers stay as stand-by workers because social costs associated with unemployment is likely to be much larger than the total expenditure for employment subsidy programmes. However, from another point of view, employment subsidy programmes protect and maintain firms and industries that are no longer competitive. No OECD countries except Japan have used employment subsidy programmes as key labour market policies after Lehman shock in 2008. Most of the OECD countries have emphasised on training/education programmes and recruitment incentive programmes instead of employment maintenance programmes. This paper examines the macroeconomic effects of subsidised employment programmes and training/education programmes in a dual labour-market framework.

When ALMPs train unskilled workers and increase labour mobility from unskilled sectors with high unemployment to skilled sectors with low unemployment, ALMPs have a direct labour-placement effect which tends to decrease aggregate unemployment by reducing mismatch in the labour market. Baily and Tobin (1977) used the Phillips curve and showed that job creation scheme may reduce the NAIRU by substitutions of low-wage for high-wage workers. Programmes may also have wage effects via expectations, which were neglected in earlier discussions. Calmfors and Lang (1995) analysed the effects of ALMPs using a standard bargaining one-sector model. They argued that ALMPs may raise wage pressure and thus reduce regular employment. Calmfors (1995) sketched the effects of retraining programmes in a two-sector framework adopting the Blanchflower-Oswald (1994) notion of a non-linear wage curve. He pointed out that ALMPs to both employed and unemployed workers may be a better policy than to target only on the unemployed.

Heckman et al. (1999) summarised the empirical studies on impacts of training programmes and concluded that such programmes does not significantly reduce unemployment. Calmfors et al. (2002) discussed the mechanism through which ALMPs affect (un)employment and surveyed the empirical studies of the effects of ALMPs in Sweden. They concluded that ALMPs may reduce both open unemployment and regular employment.

Gustman and Stenmeier (1988) studied the effect of training subsidies and wage subsidies on youth employment in a two-sector general equilibrium model. Labour was assumed to be heterogeneous in terms of ability. They concluded that both youth and aggregate employment may be increased by training subsidies for young workers. Wage subsidies for youth may have a positive impact on youth employment and an effect on aggregate employment is ambiguous. Orszag and Snower (1999) used an overlapping generation model to study hiring subsidies for unemployed workers. They analysed the interaction between deadweight (hiring rate in the absence of hiring subsidies), and displacement (the effect of hiring subsidies on the separation rate), and hiring effectiveness (the effect of hiring subsidies on the hiring rate) in a dynamic framework. An optimal employment subsidy scheme was found to lead to a reduction in aggregate unemployment.

This paper uses a two-sector general equilibrium model. I rely on the idea that wages and employment are determined by the intersection of a labour-demand schedule and a wage-setting schedule (Layard et al., 1991; Calmfors, 1994; Fukushima, 1998, 2001). The Shapiro-Stiglitz (1984) efficiency-wage model is used to model wage setting.

I study the effects of subsidised employment programmes and training/education programmes. Moreover, I shall compare the outcomes of employment subsidy programmes and outcomes of training/education programmes when the economy faces a macroeconomic shock. Section 2 sets the basic model. In Sections 3 I

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