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Growth and employment differentials under alternative wage-setting institutions and integrated capital markets

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Abstract

This paper compares the effects of different labor market institutions on economic growth and employment. In the general equilibrium model here presented, a mechanism causing persistence (on-the-job training) interacts with the strategic complementary between investors' decisions on capital accumulation and workers' decisions on labor-market participation. Within this framework (i) structurally and institutionally similar economies preserve forever their differences in output and employment levels, (ii) the steady-state growth rate is higher in an economy with competitive wage determination than in an unionized economy, (iii) this growth differential enlarges when the product and the capital markets of these two economies are integrated.

JEL Classification: J24; J51; J64; O41; R11

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1. Introduction

A basic fact emerging from the recent experience of OECD economies is that "countries with higher per capita growth rates have maintained or even increased employment over the 1990s, while employment has stagnated or even fallen in those experiencing a slowdown in GDP growth" (Bassanini et al., 2000, p. 31). In spite of the evidence that the different ability of countries to employ their labor forces has been correlated with the disparities in growth patterns across the OECD countries,[1] the research program which combines unemployment theory and growth theory is still in its infancy. The value added of the general equilibrium dynamic model presented in this paper is the contribution that it makes to such program by conducting a unified treatment of two crucial issues raised in the debate on the diverging growth and employment performances of the advanced economies.

First, the paper deals with the widespread notion that labor-market institutions more responsive to competitive forces—like those typical of the US—are conducive to better growth and employment performances than the institutional settings of many countries of Continental Europe,[2] which are more concerned with protecting incumbent workers (the "insiders"). In regard to this issue, the specific contribution of the paper consists in showing how the modalities of wage determination may affect the process by which resources strategic for growth, i.e., physical capital and trained workforce, are accumulated, thereby influencing growth and employment patterns. Growth is modeled as a self-reinforcing process. Firms' capital investment and job creation enable an increasing number of individuals to acquire skills whose availability attracts more investment and boosts the growth potential of the economy. In their turn, the jobs and career opportunities created by a fast-growing economy induce more individuals to participate in the labor market, thereby helping to ease the upward pressure on wages exerted by the increasing labor demand. In the absence of collective bargaining and institutional barriers to protect their jobs, incumbent workers have few opportunities to exploit the advantage that they enjoy with respect to outsiders because of their skills acquired on the job. As a result, a higher growth path can be sustainable when the wage-setting process is more responsive to external market forces, since in this case wage moderation and adequate profitability can be preserved even if the rates at which capital accumulates and

[1] In the decade 1991–2001, the percentage changes in real GDP and in occupied population were, respectively, 20.39 and 6.96 in France, 15.76 and −0.15 in Germany, 16.22 and 0.90 in Italy, as opposed to 39.90 and 13.99 in the United States.

[2] At the end of the 1990s, the average number of hours supplied per year by each employee is much higher in the US than in the major European countries (while thirty years ago it did not differ significantly), and in the course of the last three decades participation rates (which thirty years ago were approximately the same on both sides of the Atlantic) have diverged dramatically, remaining around 65% in Europe and rising to almost 80% in the US. As a result, this diverging trend in labor-market participation has contributed even more than the differential in unemployment rates to increasing the difference in non-employment rates, i.e., in the proportion of working-age population which is not employed, between the US and the major countries of Continental Europe (in 1997 the non-employment rate was 26.5 in the US and 42.0 in the Euro area).