



Ministère de l'emploi,
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et du logement



Pitfalls of demand policies



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What?

- I abstract from short-run macro stimulus
- Demand policies include:
 - Wage subsidies (eg cut in SS contributions)
 - Reductions in non-wage labor costs (eg employment protection)
 - Direct public employment creation
 - Malthusian policies ('work sharing')
 - Indirect measures (product market reforms)
- These are very different from one another...



Why?

- A number of structural reforms are met with political opposition
- Many demand policies are typically easier to implement
- Rewards (if any) show up more quickly than with deeper structural reforms



Pitfall #1: ignoring the supply response

- Standard models imply that the willingness to pay for labor also affects workers' alternative wage, hence wage pressure is greater
- Leads to complete or partial crowding out of immediate employment impact
- i.e. equilibrium rate of unemployment independent of productivity
- However, may get more participation and employment



Pitfall #2: opportunistic political response

- Instead of leading to more jobs, new margins of manoeuvre may just be used to hand rents to insiders.
- Typical example: fall in payroll taxes that are matched by increases in the minimum wage



Pitfall #3: creating other distortions

- Demand measures typically have to be financed, which increases distortions in other areas.
- Marginal tax rates already very high → deadweight loss may be substantial
- Ex: payroll taxes have become progressive and eventually higher to compensate for cuts at the bottom
 - Fewer incentives for wage increases and promotions
 - Fewer incentives to accumulate human capital
 - % of minimum wage earners has gone up from 10 to 16



Pitfall #4: Ignoring the economic value of the jobs being created

- Employment/Unemployment are not the ultimate objectives
- Nor is unemployment the best measure of how well the labor market works
- The social value of putting low skilled workers to work may not be very high (see Laroque (2005))
- Problem especially acute with public relief jobs
- Better arguments should be made for why we believe « employment is good »



Summary

- The problem of the labor market is not its quantitative outcome (employment rate in France same as in the US; unemployment in Canada was once quite high)
- The problem is that participation is costly because of frictions and rigidities
- « non structural » Demand policies do nothing to tackle these issues