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5 March 2013

Online at <https://mpra.ub.uni-muenchen.de/58553/>

MPRA Paper No. 58553, posted 14 Sep 2014 01:49 UTC

# LONG-TERM UNEMPLOYMENT IN THE VARIETIES OF CAPITALISM

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**Key words:** *Varieties of Capitalism, Long-term unemployment, Employment protection, Economic fallacies*

## **ABSTRACT**

Usually, when the attention is focused on the different performances of the labour market, the overall rate of unemployment is at the center stage. But this is misleading: while short term unemployment can be seen as physiological for the the working of the labour market, long-term unemployment is certainly pathological. The paper considers how the different varieties of capitalism affect the rate of long-term unemployment, rather than the aggregate rate. The liberal market variety, where employment protection is the lowest, presents lower rates of long-term unemployment than the continental European and the Mediterranean varieties. In the latter both employment protection and long-term unemployment are the highest and labour market participation the lowest. The social-democratic Scandinavian variety gets the best of both worlds: low rates of long-term unemployment, high rates of labour participation, lower degree of inequality, with relatively high levels of employment protection. However the Scandinavian model may be hardly applicable in countries, such as the Mediterranean ones, where a sizable part of public opinion apparently adheres to the various specifications of the “lump of something” economic fallacy. Low rates of long-term unemployment and high levels of labour participation are also produced by the far-Eastern Asian variety, but at the cost of a markedly dualistic labour market structure.

## 1. INTRODUCTION

The main object of the paper is to consider how employment protection leads to different long-term rates of unemployment in the different varieties of capitalism. In the varieties of capitalism literature at the centre stage of labour market performance is the aggregate rate of unemployment.<sup>1</sup> But this is misleading: the real social and economic issue is not unemployment as such but long-term unemployment. Indeed, short-term unemployment can be seen as physiological to the functioning of the labour market, while long-term unemployment is uncontroversially pathological. This paper innovates, alongside a previous one centred on issues of corporate governance (Chilosi, 2012), by putting long-term unemployment instead of aggregate unemployment as such at the centre stage of the comparison between the labour market performance of different varieties of capitalism.

## 2. EMPLOYEE PROTECTION AND REPRESENTATION, AND THE VARIETIES OF CAPITALISM

A priori we may think the different ways in which workers' interests are protected to be substitute to each other: for instance mandatory representation in corporate boards or in work councils vs. collective trade unions rights or individual employee rights. In reality rather than substitution complementarity applies, different economic and institutional traditions and different social and political values achieving different overall levels of employee protection.<sup>2</sup>

Labour market institutions, together with complementary ones relating to social policy and the economic role of the state, or the working of financial and commodity markets, allow to distinguish different varieties of capitalism. Following Hall and Soskice (2001), and Amable (2003) we may distinguish the following varieties of developed capitalist economies:

1. Liberal market
2. Continental European
3. Mediterranean European
4. Social-democratic Scandinavian
5. East Asian.<sup>3</sup>

## 2. LONG TERM UNEMPLOYMENT AND LABOUR MARKET PERFORMANCE IN THE VARIETIES OF CAPITALISM

In the tables that follow we show labour market outcomes, and in particular rates of long-term unemployment, for the above varieties, as well as the degree of employment protection, as indicated by OECD's aggregate employment protection index<sup>4</sup> (averages for the years 1991-2007):

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<sup>1</sup> Cf. Calmors and Driffil (1988), Hall and Soskice (2001, p. 20); Amable (2003). Some consideration of the issue can be found in Becker (2009), p. 157.

<sup>2</sup> Cf. Chilosi (2012). Hall and Soskice, following Aoki (1994), rather than pointing to the different ideological and cultural backgrounds, consider the issue in terms of efficiency, as complementarity between institutions applies when the "presence (or efficiency) of one increases the returns (or efficiency of the other)".

<sup>3</sup> Hall and Soskice concentrate their analysis on the dichotomy between liberal market and coordinated market economies, but also a separate Mediterranean variety is mentioned by them (p. 21).

<sup>4</sup> "Unweighted average of version 1 sub-indicators for regular contracts (EPR\_v1) and temporary contracts (EPT\_v1)", where EPR\_v1 is "sub-indicator for dismissal of employees on regular contracts" and EPT\_v1 is "sub-indicator for strictness of regulation on temporary contracts". "Summary indicators are on a scale from 0 (least restrictions) to 6 (most restrictions)" (OECD 2010).

Table 1. Long -term unemployment, employment protection, and the varieties of capitalism: the Liberal Market, Central European and Mediterranean European varieties<sup>a)</sup>.

	Long-term unemployment rate	Unemployment rate	Participation rate	Youth long-term unemployment rate	Employment protection index
USA	0.5	5.4	66.1	0.6	0.21
UK	2.2	6.7	61.4	2.7	0.66
Canada	1.0	8.4	65.6	0.7	0.75
Australia	2.0	7.4	63.5	2.6	1.05
Ireland	4.5	8.4	57.4	5.5	0.98
New Zealand	1.3	6.5	65.2	1.6	1.15
<b>Average</b>	<b>1.9</b>	<b>7.1</b>	<b>63.2</b>	<b>2.3</b>	<b>0.80</b>
Germany	4.2	8.6	58.5	2.5	2.54
France	3.8	10.3	55.3	5	3.01
Belgium	4.5	8.2	51.1	6.6	2.52
Netherlands	2.2	4.8	61.4	0.6	2.4
Austria	1.2	4.1	58.3	1.1	2.13
<b>Average</b>	<b>3.2</b>	<b>7.2</b>	<b>56.9</b>	<b>3.2</b>	<b>2.52-</b>
Italy	5.8	9.8	48.1	15.8	2.69
Spain	7.3	15.5	52.4	10.9	3.31
Greece	5.1	9.6	52.1	13.3	3.27-
Portugal	2.5	5.9	60.7	10.9	3.67
<b>Average</b>	<b>5.2</b>	<b>10.2</b>	<b>53.3</b>	<b>12.7</b>	<b>3.24</b>

Country averages for the years 1991-2007. Source: ILO (2011);. last column: OECD (2010).

Table 2. Long -term unemployment, employment protection, and the varieties of capitalism: the Scandinavian, and East Asian varieties.

Country	Long-term unemployment rate	Unemployment rate	Participation rate	Youth long-term unemployment rate	Employment protection index
Denmark	1.5	6	66.1	0.8	1.71
Finland <sup>5</sup>	2.9	10.8	61.7	1.9	2.08
Sweden	1.7	7.1	64	2.3	2.44
Norway	0.6	4.3	65.6	0.6	2.69
<b>Average</b>	<b>1.7</b>	<b>7.1</b>	<b>64.4</b>	<b>1.4</b>	<b>2.23</b>
Japan	1	3.9	62.4	1.3	1.58
Korea	0.1	3.5	61.2	0.1	2.32
Taiwan	NA	3.1	NA	NA	NA
Singapore	0.1	3.7	65.4	NA	NA
Hong Kong	NA	4.3	61.4	NA	NA
<b>Average</b>		<b>3.7</b>	<b>62.6</b>		

<sup>a)</sup>Country averages for the years 1991-2007. Source: ILO (2011);. last column: Oecd (2010).

<sup>5</sup> Finland relatively high rates of unemployment may be explained as a consequence of the economic shock of losing Soviet trade after 1990.

Table 3. *The varieties of capitalism: resilience to the crisis. Average rates of long-term unemployment in the years 2008-2011*

USA	1.9	Germany	3.4	Italy	3.7	Denmark	1.1	Japan	1.6
UK <sup>6</sup>	2.1	France	3.4	Spain	5.7	Finland	1.5	Korea	0.0
Canada	0.8	Belgium	3.6	Greece	5.5	Sweden	1.1		
Australia	1.0	Netherlands	1.1	Portugal	5.3	Norway	0.3		
Ireland	5.0	Austria	1.0						
New Zealand	0.4								
<b>Average</b>	<b>1.9</b>	<b>Average</b>	<b>2.5</b>	<b>Average</b>	<b>5.1</b>	<b>Average</b>	<b>1.0</b>	<b>Average</b>	<b>0.8</b>

Source: ILO (2012)

Table 4 *Unemployment by duration: average number of months*

	Australia	Canada	USA	Europe	G7
1991-2007	2.6	4.8	3.8	14.4	4.0
2008-2011	1.8	4.2	6.6	14.6	6.4

Source: OECD; averages of the two periods. NB: the OECD table includes only a few countries or countries aggregates. No singular European country is included with complete data for the period. Partial data are available only for Finland and Norway.

From the data reported in the tables 1 and 2 above it turns out that, with the notable exception of the Scandinavian and Far Eastern varieties, wherever there is greater employment protection, long-term unemployment is on average higher, and the participation rate lower. On the other hand, as it could be expected, the relation appears to be different inside the different varieties in the different countries, as the impact of employment protection depends on the specificity of the different institutional contexts and circumstances such as, for instance, the extent of compliance and different juridical practices, or the extent and duration of unemployment subsidies, and the type of economic policies concretely pursued.<sup>7</sup>

Looking at the individual countries we can see that there are two clear outliers: Ireland and Austria. Ireland has a long-term unemployment performance akin to that of the Central European and Mediterranean countries, notwithstanding a low level of employment protection. It is notable however that following favourable external factors as well as policy choices (such as centralized bargaining leading to wage moderation) its performance markedly improves since the half of the nineties<sup>8</sup>, leading to very low rates of long-term unemployment that are comparable to those of the other liberal market economies towards the end at the nineties and during the following decade until the crisis.<sup>9</sup> Austria, whose institutions make it close the social-democratic Scandinavian model, has low level of long-term unemployment, together with a high level of employment protection. This applies to

<sup>6</sup> Finland relatively high rates of unemployment can be explained as a consequence of the economic shock of losing Soviet trade after 1990.

<sup>7</sup> For a similar remark, on the dependency on other institutional circumstances of the impact of employment protection legislation on labour market flows see Boeri, Van Ours, 2008, p. 213.

<sup>8</sup> Cf. Walsh (2002).

<sup>9</sup> Amable (2003, p. 173), contrary to Hall and Soskice, puts Ireland in the Central European variety. We have followed Hall and Soskice owing to Ireland's low index of employment protection and the Anglo-Saxon legal tradition common with the other economies of the group.

lesser extent also to the Netherlands.<sup>10</sup> We have put France in the central European variety following Amable, but it is on the borderline: indeed, according to Hall and Soskice (p. 21) it belongs to the Mediterranean variety (“marked by a large agrarian sector and recent histories of extensive state intervention”).

If we now turn to the aggregate rate of unemployment, we see that the differences between the different varieties are much smaller. For the liberal market, central European and Scandinavian varieties the difference is practically nought. The rate is about half in East Asia, and about one third higher in the Mediterranean variety. From the above data we may draw the conclusion that in the liberal market and Scandinavian varieties the labour market is on average markedly more dynamic than in the other ones, as borne by the implied higher rates of short-term unemployment (but job to job transfers, another aspect of labour market dynamics, are not considered here).<sup>11</sup> It is in fact to be expected that short run unemployment to be higher in the liberal market economies where layoffs (and thus hirings) are less difficult and costly. Moreover leaving a job in order to look for a better one, and to be more choosy in accepting a new job when laid off, is less risky than wherever rates of long-term unemployment are higher (especially if unemployment subsidies are generous, as is the case in the Scandinavian countries).

#### 4. THE SPECIAL SCANDINAVIAN CASE: THE BEST OF BOTH WORLDS?

According to the above data the Scandinavian model produces the best of both worlds: high levels of labour market performance with low levels of long-term unemployment, as well as high levels of employment protection, together with comparatively greater equality (as shown in table 5 below).<sup>12</sup>

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<sup>10</sup> According to Boyer 1997 classification, quoted in Amable (2003, p. 83), Austria belongs, together with the Scandinavian countries, to a common social-democratic model. According to Andersen et al. (2007, p.14) not only Austria, but also the Netherlands, another possible outlier, are close to the Scandinavian (or “Nordic”) model.

<sup>11</sup> In countries where there is greater job protection the dynamics of the labour market could take the form of greater job to job transfers (Skedinger, 2010, p. 118). To have a dynamic labour market is particularly important for innovative and technological advanced production activities, where risks and rewards are potentially higher, and the burden of an almost fixed labour force protected from lay-off much more troublesome.

<sup>12</sup> As well as relatively high rates of economic growth (cf. Anderson et al., 2007, p. 15). Acemoglu et al (2012) argue that the success of the Scandinavian economies has been made possible by the technological progress engineered by the more unequal, competitive and business friendly American system, which pushes forward the technological frontier to the advantage of everybody else. In other terms, according to them the Scandinavian model enjoys external advantages that would not occur if it were universally adopted. However Acemoglu’s contention is not borne out by actual data, as provided by the Global Innovation Index (GII 2012). In the Global Innovation Index rankings the United States occupies the tenth position, preceded by Sweden (rank 2), Finland (rank 4), and Denmark (rank 7). In the innovation output index sub-ranking the United States ranks 16-th and is preceded by the Scandinavian countries. For a commentary of the relative USA position see p. 15 of GII 2012 which concludes that “in a series of indicators, the USA has been facing a weaker performance. This is particularly evident in specific areas, mostly those linked to education and the tapping of global talent, and to research, patenting, and scientific publications.” Moreover there is always the doubt of how much the economic outcomes of a particular country are the product of formal institutions rather than of the peculiar characteristics of the country itself, as rooted in its history, geography and demography. In particular, the alleged high propensity toward risk and enterprise, and the innovative propensity of the American economy, could be due, rather than to the absence of a safety net, to a system of values which leads to the choice of not having a safety net at all (on the different value systems and the different perception of poverty and inequality in the USA and Europe, see Alesina, 2006). The safety net in itself is not adversary to taking risks, on the contrary it may reduce the personal riskiness of otherwise risky innovative activities: you may take risks more lightly if in case of bad luck the safety net guarantees a minimum living standard instead of the prospect of utter destitution. Indeed, a collective safety net provides a sort of collective insurance against

Table 5. Levels of inequality (Gini coefficients) and varieties of capitalism

<b>USA</b>	45	<b>Germany</b>	28.3	<b>Italy</b>	36	<b>Denmark</b>	23.2	<b>Japan</b>	38.1
<b>UK</b>	36	<b>France</b>	26.7	<b>Spain</b>	34.7	<b>Finland</b>	26.9	<b>Korea</b>	35.8
<b>Canada</b>	32.6	<b>Belgium</b>	33	<b>Greece</b>	35.1	<b>Sweden</b>	25	<b>Taiwan</b>	NA
<b>Australia</b>	35.2	<b>Netherland</b>	30.9	<b>Portugal</b>	38,5	<b>Norway</b>	25.8	<b>Singapore</b>	42.5
<b>Ireland</b>	34	<b>Austria</b>	31						
<b>Average</b>	<b>36.6</b>	<b>Average</b>	<b>30</b>	<b>Average</b>	<b>36,1</b>	<b>Average</b>	<b>25,2</b>	<b>Average</b>	<b>38,8</b>

Source: *WorldFactbook* 2007. The lower the value of the Gini coefficient, the lower is inequality

How does the Scandinavian model produce its labour market remarkable outcomes? As explained by a group of authoritative Scandinavian economists (Andersen et al, 2007), the labour market institutions entail “high unionization, highly coordinated wage bargaining geared to wage compression, active labour market policies, and relatively generous unemployment benefits” (p. 40). Social cohesion<sup>13</sup> and centralized decision making bring about wage moderation, the possible consequences of wage increases on aggregate employment are to some extent internalized. At the same time active labour market policies contribute to achieve low levels of incidence of long-term unemployment.<sup>14</sup>

## 5. IS THE SCANDINAVIAN MODEL EXPORTABLE?

It seems unlikely that the Scandinavian model could be easily exportable elsewhere. It is certainly not exportable wherever the trade union movement is fragmented and subjected to the competition of “ultras” trade unions sharing the zero sum view of a class struggle ideology, leading to a wage push incompatible with relative price stability and full employment, or whenever trade unions are poised to the defence of specific sectoral interests rather than paying attention to overall workers’ interests (including those of the unemployed). In general “economies at the extremes - with highly centralized or highly decentralized labour markets – [have] better employment records than those economies 'betwixt and between'” (Freeman, 1988, p. 65)<sup>15</sup>. Moreover, independently of the formal institutions, cooperative solutions such as of the Scandinavian type are more difficult to achieve wherever, as it may be the case in Mediterranean countries, important sections of public opinion and of the political class, as well of the trade union movement, are prone to wishful thinking and share the popular economic fallacies expounded in the appendix. The corresponding cultural background may be reflected not only in the extent of labour protection granted by the formal legal framework, but also in the way in which it finds actual judicial application. Finally

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destitution, in case the bets get sour, at much lower costs and lower moral hazard (since there is no problem of adverse selection and there is the advantage of increasing returns to scale), and with more complete coverage, than private insurance, even if it is true that the taxes needed to finance the collective safety net could have a negative impact on incentives. But in theory at least the latter is not a foregone conclusion. Usually the substitution effect of taxation is considered in popular discussions, but the income effect should also be taken into account, which would work in the opposite direction. Obviously much depends on the specific way the tax system is structured, and, in an international context, on the mobility of the relevant production factors. (On the ways in which a safety net can favour growth see Alderman and Yemtsov, 2013.)

<sup>13</sup> “The system is based on social cohesion in the sense of a perception that we are all, in one way or another, in the same boat” (ibidem, p. 65).

<sup>14</sup> For a sober appraisal of the efficacy of active market policies in Sweden see however ibidem, p. 115.

<sup>15</sup> On this see in particular Calmors and Driffil (1988).

“Nordic countries are small and ethnically homogeneous ... Ethnic homogeneity is conducive to the emergence of trust, the key ingredient in “social capital”, which is widely believed to improve the efficiency of society by facilitating coordinated action. In fact, the level of trust is higher in the Nordic countries (and the Netherlands) than elsewhere according to available indicators” (Andersen et al., 2007, p. 39). But these peculiarities of the Scandinavian (or “Nordic”) social model are challenged by the recent processes of massive immigration (ibidem).

## 6. WHAT ABOUT THE SOUTH-EAST ASIAN MODEL?

It is based on a dualistic labour market solution: the core employees enjoy protection of their job legally or implicitly while the workers in the secondary market are subjected to a high degree of flexibility and much lower pay, functioning as a buffer stock. In particular there is high supply elasticity by the female component of the labour force, with a high propensity to retire from the labour market in case of downward employment pressure, as related to more traditional family values. In Japan “the majority of employees such as female employees, part-time workers and workers in smaller firms are not covered” by the long-term employment system reserved to men employed in big enterprises (Tachibanaki, 2000, p. 11). The coexistence of a core section of protected workers with a relatively large one of lesser paid temporary employees can be found also in the case of Korea, where the recorded incidence of long-term unemployment is minimal.<sup>16</sup>

## 7. INSIDERS AND OUTSIDERS

Let us return to what seems to be the more feasible alternative outside Scandinavia, a trade-off between employment protection and long-term unemployment. As it turns out from the data above the continental and Mediterranean varieties lead to better protection of insiders wishing to maintain their jobs, the Anglo-Saxon liberal market variety of outsiders wishing to find a job, as shown by the much lower average long-term unemployment rates in the latter variety. Putting ourselves in the perspective of the preferences of a representative worker over alternative institutional arrangements, it is by no means clear a priori that even the representative unemployed, if given the choice, would prefer a liberal labour market system, notwithstanding the lower probability to end up as long-term unemployed in the latter case. Indeed, even an unemployed worker may prefer to trade-off the greater difficulty of finding a job now with the shield provided by employment protection once a job is found.

Surprisingly enough, empirical inquiries in the satisfaction associated to different contractual arrangements in different normative setups do not report better feeling of security in case of stronger legal protection of permanent employment contracts. Wherever private employees are less protected, paradoxically they feel more secure: the empirical studies surveyed by Per Skedinger (2010) “indicate that employees with permanent jobs perceive less security in countries with stricter legislation” (p. 118). In Clark and Postel-Vinay (2009, p. 207) “workers feel less secure in countries where jobs are more protected” (with the exception of “permanent public jobs, suggesting that such jobs are perceived to be by and large insulated from labor market fluctuations”).

The positive relationship between labour market protection and long-term unemployment that is shown in the tables above can be an obvious explanation of the latter result. In the end

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<sup>16</sup> Grubb, Lee and Tergeist (2007), p. 12.

greater security in the job does not lead to labour market security, aside from public employment, where security in the job is felt to be absolute.<sup>17</sup>

One may also consider that even when there is no legal employment protection *de facto* protection is provided by the interest of the employer to continue to take advantage of the services of the employees and to maintain a good working relationship with them. An unjustified dismissal, even if not sanctioned by the law, may be sanctioned by reducing the trust that the employees have on the employer, and their work proficiency. Whenever there is legal protection and the burden of proof in demonstrating that the dismissal was justified lies with the employer there is a high probability that the employees who have recourse to a court of law against an alleged unfair dismissal have been in reality dismissed fairly (remember the standard distinction between to observe and verify: one thing is to observe something, such as untrustworthy or inefficient and incompetent behaviour, another to be able to prove it in a court of law). This ultimately may turn against the broad interest of workers as a whole, increasing the cost of labour for any given wage level, and reducing productivity and opportunities of employment.

An additional cost from the viewpoint of workers' welfare could be the greater probability of entrapment: as high rates of long-term unemployment tend to be associated with stronger legal protection of permanent employment, to leave a secure, even if unsatisfactory, job in order to look for a more satisfactory one could be too risky a decision. This impairs the allocative function of the labour market and the way in which workers pursue the search for more productive (and better paid), as well as more satisfactory, jobs.<sup>18</sup> In the end greater labour mobility could have positive effects on allocative efficiency, while higher wages could compensate for the negative welfare consequences of higher labour mobility ("churning rate").<sup>19</sup>

The above considerations are in agreement with the results of Origo and Paganì (2009). According to their inquiry on workers' job satisfaction, using the micro-data of the Eurobarometer Survey, "job stability and perceived security are not the same thing ... job satisfaction is relatively low mainly when perceived job security is low. In addition, the combination 'temporary but secure job' (hence, the lack of only job stability) seems preferable to the combination 'permanent but insecure job' (that is, the lack of only job security). This indicates that the length of the contract may be less important if the worker perceives that s/he is not at risk of becoming unemployed" (p. 554).

Aside from what appears to be the case in the Scandinavian social-democratic variety, the protection of what is considered to be the weaker side in the employment relationship, the employee, can be to the cost of even weaker actors, the long-term unemployed, or the employed in the secondary labour market, as well as the discouraged workers. At the same time the weakness of the employee position, *ceteris paribus*, is all the greater the lower the probability of finding a job in case of layoffs and the lower the unemployment benefits (which are not considered in the present paper). Here the legislator faces trade-offs, which are

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<sup>17</sup> "‘Job security’, taken literally, applies to security within the present job, while ‘labour market security’ is a wider concept which also includes the possibility of finding a new job if an employee has been fired" (Skedinger, 2010, p. 113).

<sup>18</sup> As expounded, in particular, by the hedonic theory of wages. On the negative consequences of employment protection on labour mobility and productivity growth see Martin and Scarpetta, 2011.

<sup>19</sup> Cf. Böckerman et al. (2011).

dealt with in the different varieties of capitalism, as well as in the different countries, in different ways.

## 8. THE DYNAMIC PERSPECTIVE

Looking at the dynamic perspective, of changing the institutions of labour market, and, in particular, employment protection, it is conventional wisdom that the employed are usually a much larger proportion of the labour force, and of the electoral constituency, than the unemployed, and their voice by way of the trade unions may be louder. Moreover the employed, alike anybody else, may have a propensity to look at their perceived individual interest rather than to the broad picture. Thus, *ceteris paribus*, it may be politically easier to increase rather than decrease employment protection. At the same time, if increased employment protection leads to lower probability to outflow from unemployment, thus increasing the loss associated to lay-offs, the perceived interest of the employed in employment protection is enhanced and any reduction in protection may become politically more difficult. The contrary process could lead, for reciprocal reasons, to the opposite outcome; thus labour market reforms could acquire their own momentum.<sup>20</sup>

## 9. CONCLUSION

In the end the choice between the varieties of capitalism, or the wholesale rejection of them, is a matter of individual, and, in the aggregate, social, preferences and social choice. But one should not be deluded, as is often the case, by wishful thinking as to the overall consequences of employment protection in the different social and institutional environments. And attention should always be paid to the true nature of the outside options and of the opportunity costs, avoiding what we may call the general Nirvana fallacy: if some social arrangement is not perfect it should be rejected because perfection is just around the corner.<sup>21</sup> Moreover what is relevant is not what alternative is theoretically possible, but what is actually possible.

Turning to current European debates, we may see that the countries making up the European Union belong to different varieties of capitalism, embedded in different historical, cultural and legal traditions. The pretence by some political forces to impose a particular variety at the level of the European Union, in particular with respect to the subject matter of the present paper, the discipline of the labour market, may put the European Union institutions into needless dangerous strains.<sup>22</sup> This may be an area where the benefits of institutional variety, in terms of learning, competing, and adapting to local conditions and traditions, outweigh the advantages of institutional uniformity in establishing a formal play level field for European businesses.

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<sup>20</sup> On the political economy of employment protection and related literature see Bertola (1998), Saint-Paul (2002).

<sup>21</sup> For the Nirvana fallacy see Demsetz (1969, p. 1): "The view that now pervades much public policy economics implicitly presents the relevant choice as between an ideal norm and an existing 'imperfect' institutional arrangement. This nirvana approach differs considerably from a comparative institution approach in which the relevant choice is between alternative real institutional arrangements."

<sup>22</sup> Of course there is the argument of externalities, firms in a country where the labour protection legislation is more stringent can find some difficulty in competing with countries where the protection is lower. But this applies in general to the whole world, and in case competitiveness were affected by the stiffness of the labour market some correction could be found in the wage levels. In practice however the burden of adjustment may fall on the unemployed, on secondary workers, and on productivity growth. And there seems to be no consensus in Europe as to what extent the interest of insiders should be privileged in relation to outsiders.

## **APPENDIX: THREE POPULAR ECONOMIC FALLACIES**

Three popular economic fallacies often mar the public discourse about labour law, economic systems, and (un)employment (as well as about any other possible issue of economic policy). The first and the third are widely known and are taught in a way or another to students of economics at the introductory level.<sup>23</sup> The lump of labour fallacy is known especially to labour economists. Its generalization as the “general lump of something fallacy” is my personal contribution.

### **1. The fallacy of composition**

If something is good for somebody it is good for the whole class of people to which the person belongs: if a worker’s job is protected, and this protection is extended to all the jobs, this turns to the advantage of all the workers.

### **2. The lump of labour, and lump of something, fallacy**

The amount of work to be done is given and independent of the provisions of the labour law. This fallacy can refer to other objects of discourse, whenever they are taken as independent of the relevant legal provisions: the number and structure of firms, entrepreneurs, or whatever else. We may call the generalization of the lump of labour fallacy as the general lump of something fallacy. Turning to labour law, the provisions of the latter affect the number of jobs not only by varying existing firms’ demand of labour (i.e. offers of employment), but also the set of existing firms (i. e. employers) and the supply of entrepreneurship (of those willing to start and to develop a firm and create jobs). To some extent the fallacy of the lump of something is based on a confusion between the short and the long run: jobs, firms, entrepreneurs are given at a certain moment of time, but are by no means given in the longer time frame in which legal provisions exert their effects.

A popular instance of the lump of labour fallacy refers to the idea that if somebody retires, his job is available for somebody else, and thus unemployment can be reduced by lowering the retirement age.

A popular instance of the lump of something fallacy is the idea that rent control does not affect the supply of dwellings for rent but only the distribution of income between landlords and tenants.

### **3. The zero sum fallacy**

If somebody gets something more it means that somebody else gets less, if somebody’s lot is improved, somebody else’s must be worsened. Thus if employers gain, it means that workers lose, and vice-versa: a wage rise or a legal provision strengthening the bargaining power of trade unions, or enhancing jobs protection is considered to be always to the advantage of workers, even if it leads eventually to bankruptcy and closure of the firm, or to loss of competitiveness and slowing down of economic growth, higher long-term unemployment or high inflation.

Here too the fallacy concerns the time frame: what looks favourable in the short run may be ruinous in the longer run.

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<sup>23</sup> The first is expounded for instance in Samuelson’s Economics textbook, the third results from the notion itself of Pareto improvement.

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