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Work and the new challenges of economic reality

E. Malinvaud¹

This contribution to the Symposium takes place as one of the three thematic presentations following the general introduction offered by H. Em. Cardinal Camillo Ruini. It is supposed to be the message of an economist addressed not in particular to his colleagues economists but rather to all participants. I apologize for my inevitably selective choice of issues, a choice that I shall not attempt to justify. In fact, three broad questions, with attendant issues, will be raised :

How can academic economists serve for the implementation of the Christian ethics on work?

How are macroeconomic policies now understood in economics as favoring human fulfilment, particularly with respect to work, and in Europe, embedded as it is in the present aging and globalizing world?

Given the fairly recent demand for more flexibility in European labor markets, how does economic research assess the positive and negative effects of various structural policies aimed at meeting this demand?

1. Christian ethics and the economists

Concerning Christian teaching, I have a few points to raise about four broad issues: an old misunderstanding between moralists and economists; the meaning of the phrase "work is for man and not man for work"; the priority of labor over capital now; tone of the Social Doctrine in particularly challenging times.

1.1 A long misunderstanding

After almost two centuries the time should be reached now for clearing up the misunderstanding between humanists and economists about the responsibility of the latter in the decline of values within modern societies. Use of the phrase *homo economicus* would prove that we economists have been and still are promoting a selfish and greedy behavior. In a brief attempt to acquit my profession of at least a good part of this charge, I shall make four points.

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Most of us are careful to distinguish behavior of humans in economic matters from behavior in other matters. This was the concern of John Stuart Mill in 1836 when he isolated the "economic man" from man involved in other activities. This was also the concern of Vilfredo Pareto in 1906 when he clearly singled out "*homo oeconomicus*" for study in his *Manuale di Economia Politica*.

Second, most of us avoid claiming competence on matters examined by philosophy or by other social sciences than economics. For instance, only few economists support in its embracing ambition what Gary Becker called "the economics of the family".

Third, we distinguish normative economics from positive economics. Our dealing, in normative economics, of such objectives of public policy as social justice or preservation of the environment brings in values that are fundamentally different from self-interest and often opposed to it. Positive economics, which aims at *explaining* phenomena recognized as directly influenced by economic behavior of households, firms and other economic agents, has to take account of the role self-interest. This role is indeed obvious, and most often easily understood in economic behavior.

Fourth however, positive economics itself more and more now recognizes that other motivations than self-interest also play a role in economic behavior. These reflect altruism or conscience of a duty, which often are important objectives of the agents. They translate into a concern for reciprocity and justice, which is embodied in norms of behavior even for economic matters.

Perhaps moralists should moreover reflect on the fact that many among academic economists chose their field of study because they had the humanist motivation to contribute to improving the operation of the economy, with respect to such evils as unemployment or poverty.

1.2 Difficulties with the phrase "Work is for man and not man for work"

In this presentation I cannot be silent on the Social Doctrine of the Church about work and employment, because the doctrine will be an important item in our thematic discussions, particularly in Areas 1 (work and fundamental ethical instances) and 6 (work, the social doctrine and the experience of European Catholic movements). But I must be brief, because I have nothing to say about the fundamental tenets of the doctrine. So, I decided to stir your attention by making three short comments which, according to me, deserve discussion in this symposium.

The first one disputes the advisability of promoting the sentence "Work is for man and not man for work", which appears at the center of the four paragraphs circulated as announcing the main focus of the symposium. The sentence may also be found in Chapter Six of the recently published *Compendium*² (section 272).

Taken out of the context of the full social doctrine, but rather read in the context of the present individualistic culture, the sentence in question may very well suggest an interpretation with a quite different spirit from that of the encyclicals. I might read it as: "My work is for my own satisfaction and I have not to feel bound by the work I am supposed to do". Indeed, let me ask: how could the second part of the now fashionable sentence, "man is not for work", be reconciled with for instance section 16 of *Laborem Exercens* according to which work "is an obligation, that is, a duty on the part of man"? And, according to me, the first part of the sentence, "work is for man", should be reformulated so as to convey the meaning of the individual working for others, within what economists have long been used to call "the division of labor". The first part of the sentence would avoid misinterpretation if it was rather written as: "work is for the common good and for the fulfilment of human needs and values".

1.3 The priority of labor over capital now

About the priority of labor over capital I shall not recall here what is exactly the meaning of this fundamental tenet of the doctrine³, but rather say a few words on a side issue that might deserve attention in the thematic discussions of this symposium. Indeed, the encyclicals are clear on the meaning of the principle in question, particularly after the complement brought to it by *Centesimus Annus* (n. 32) about entrepreneurship: "Organizing the productive effort, planning its duration in time, making sure that it corresponds in a positive way to the demands which it must satisfy, and taking the necessary risks, all this too is a source of wealth in today's society. In this way, the role of the disciplined and creative human work and, as an essential part of that work, initiative and entrepreneurial ability becomes increasingly evident and decisive".

The side issue which now appears as particularly disturbing concerns the distribution of the income earned between the return to work and the return to capital, a distribution that was so much in favor of capital during the second part of the 1990s. I believe that, in a decade from now when these years will be seen in retrospect, they will be understood as having been exceptional. There may also be a reason for some permanent increase in the return to capital, namely that modern gains

²Pontifical Council for Justice and Peace, *Compendium of the Social Doctrine of the Church*, Libreria Editrice Vaticana, 2004.

³For a presentation of mine, see pages 105 to 112 in E. Malinvaud, ed., *The Meaning of the Priority of Labour*, Pontifical Academy of Social Sciences, Miscellanea 4, 2004.

in productivity have become more dependent on risk-taking, which will naturally have to be rewarded, beyond what accrues to saving. Nevertheless, during the next two days a serious consideration of recent trends in the return to capital and to entrepreneurial activity would be well deserved.

1.4 Challenges of the coming decades

When reflecting about the economic future of European countries and of the European Union my natural inclination to optimism is failing, because I do not think we are ready to cope with the challenges ahead. Such a mood leads me to wonder today whether and how the Social Doctrine of the Church could help us to cope. I hasten to add that I do not have the answer. But the question may not be misplaced in this symposium. Hence, I shall now point to the challenges and speculate on whether the tone or balance of the Christian teaching ought not to be reconsidered, in some respects to be determined.

What are the main economic challenges? First comes, of course, mass unemployment, which was manifest after 1980 and still is manifest in large parts of Europe. The fact is too obvious for requiring elaboration. Second, and still more worrying, come the problems which will result from aging. Although known to exist, these problems and their progressive worsening during the next four decades are not fully perceived. The fact is that the life cycle of people born in 1960 will have to be less easy, with respect to work, earning and/or consumption, than the life cycle of those born in 1940. And the life cycle of those born in 1980 will be still more strenuous, again with respect to work, earning and/or consumption.

If the fact is worrying, it is not only because people do not see how large are the efforts to be inevitably made, but also because great uncertainties exist about the increase in the cost of health care for the old, an increase to be borne concomitantly with the ones directly following from aging. Worry moreover comes from the fact that, on the eve of a likely large and prolonged increase in public transfers, we seem to be unable to now insure the balance of public budgets. This means that our people, particularly the generation of young adults, will have to contribute to a much more severe fiscal redistribution than their grand parents had to.

A third substantial economic challenge comes from world trends, with not only the increase in foreign competition due to globalization, but also awareness of the growing urgency of more determinate environmental policies. A diagnosis about what was required from the European Union was made in Lisbon five years ago. It stated that a strong effort had to be devoted to upgrade education and to promote a big push in research and technological development. For the time being, it

is hard to detect a serious implementation of "the Lisbon agenda". Part of the problem is again that our public finances are perceived as already too straining.

Implementing the Lisbon agenda, coping with aging, even insuring a high and lasting employment are long-term economic challenges. It is unfortunately well known that, because of their inner functioning, democracies tend to be shortsighted: they focus on the solution of short-term problems and repeatedly delay the solution of long-term ones. Thus, three economic challenges turn into a big political and institutional challenge.

Existence of these challenges imply no revision of the fundamental principles of the Social Doctrine. But the Church in Europe should envisage scenarios in which she would have to dispense her teaching during coming decades when perhaps levels of living and hourly real wages would experience declining trends, so that improving the relative conditions of the poor and the disabled would require more work and less consumption in large social strata. Such an assessment is quite general and probably too sweeping in this symposium. But you understand that, if we would undertake its detailed examination, we would inevitably come across burning questions about work ethic.

2. Macroeconomic policies for human fulfilment

Since the third and last part of this paper will concentrate on structural policies addressed to the labor market, I do not want to now restrict what I am going to say on other policy issues. This is why I shall accept a broader definition of macropolicies than is most often found in textbooks. In fact I shall, first, exhibit the spirit in which the methodology of economic policy-making is being examined in current research and I shall draw some implications. I shall, second in this part, consider the long and unfinished dispute that, since Keynes' *General Theory*, bears on the role of aggregate-demand-management policies.

2.1 The methodology of economic policy-making in Western democracies

In this general presentation I cannot really survey the literature on this subject. Indeed, research about it may look at places quite abstract and it still leaves room for substantial disagreements. But the importance of its content may be explained in simple terms. There are two main objectives: (i) to clarify the assignment of roles in policy-making, and (ii) to specify policy rules to be followed. A natural framework serves for the study of these two objectives. Let me define it.

Our economies operate with a large degree of decentralization. Productions, prices, incomes are the joint result of many decisions, most of them taken by private agents. Private decisions and their subsequent outcomes will depend on the expectations entertained by whoever has to decide. These expectations bear on all significant features of the environment within which the outcomes will mature. Among these features some will depend on future public decisions. As a result, some effects of public policies will depend on their impact on the formation of expectations about future public decisions. This net of interactions between public decisions and private expectations is important and natural to consider in our decentralized economies.

A serious study of the interactions requires in particular that we closely examine the formation of expectations. Often my colleagues economists speak as if they were unaware of the difficulty. A password, namely "rational expectations", would suffice to clear out the issue. Indeed, that is one of the passwords you are induced to using in order to obtain publication of your papers if you are an economist. But who can be sure of the validity of the model within which you are making sense of the concept of rational expectation? As for me I claim that, at this time, the priority often is for empirical investigations about the formation of expectations, rather than for armchair guessing in favor of a model that would at a stroke give everything you need about your domain of study, including what agents' expectations will have to be. I shall not insist on this warning, which for me today is just a side consideration. I just wanted to point to the fact that economic policy analysis may lead to really thorny questions.

Nevertheless, important advances were recently made on the methodology of policy making. To give an idea of the outcome of this research, I shall summarize it as follows. Good policy rules would cope both with the long-run concerns of citizens and with the short-run needs for adaptations to frequent changes in the macroeconomic climate. The rules should be such as to establish and maintain simultaneously (i) the reputation of public decision-makers to be abiding by these rules, and (ii) confidence of private agents in the idea that governments will not interfere in the strict application of the rules. However, maintaining reputation and confidence will be exacting because shortsighted governments will often be tempted to interfere so as to reap political short-run gains, even if it is at the cost of jeopardizing the reputation and confidence in question.

Given this, two means exist for institutional arrangements that will prevent governments from so doing. The first one is to give to some public decision-takers statuts making them independent of government, while assigning to them specific operational objectives. Such are now the statuts of many central banks, including the European Central Bank. A second means is to tie government freedom

with long-run commitments ruling out some decisions likely to disrupt confidence. Such are the objectives for budgetary policy, that are specified in the European Union Stability Pact.

2.2 A long dispute between economists about the effectiveness of demand management policies

As is known by everybody, the great English economist John-Maynard Keynes convincingly argued, in a book published in 1936, that properly active monetary and fiscal policies would contribute to full employment, which was a particularly strong concern at that time. Many precursors had argued along similar lines before, but up to then they had little impact in teaching, which on such matters was dominated by the traditional posture of economists on "sound government finance" with for instance public budgets maintained permanently in balance. By 1960 contributions of the famous 1936 book were embodied in courses of economics almost everywhere. Governments in market economies, as well as international organizations such as OECD, had become adept of active macroeconomic policies, for the preparation of which econometric macromodels were either used or being built. A few economists early argued against the then dominant teaching, the best known of whom being Professor Milton Friedman. But, for still some time, they were not much listened to.

However, their ideas penetrated macroeconomic research in the 1970s, before becoming dominant in the most influential universities. Progressively active Keynesian policies were discredited, although a substantial part of the intelligentsia and public opinion remained unconvinced. I must now try to say, in a few words, what is the state of the issue today.

On the one hand, the critics were right in some respects, particularly when they state that Keynesian policies were less powerful than was announced by the teaching dispensed in the 1960s. Some active governments lost their credibility to the point where even consumer confidence was affected and where rise in medium- and long-term interest rates were reflected by low investment. Or taking an opposite direction, some severe government programs restored confidence and these programs were surprisingly followed by upturns in economic trends.

On the other hand, the basic proposition of the new classical school, according to which markets would spontaneously clear for the better if public authorities would not interfere, was disproved over and over again, notably by financial crises. In the countries which most effectively coped with such shocks central banks carefully adapted their policies so as to stimulate activity in depression times.

Not surprisingly the teaching of economics then started deviating from the dogmatic stance that was fashionable during two decades. A catchword was found with the phrase New Keynesian Macroeconomics, which actually covers a disparate range of theories, but permits a better recognition of the true complexity of macroeconomic phenomena.

3. The labor market and structural policies

3.1 Rigidities of the labor market

As an institution the labor market is very different from the market for goods or the market for capital. It directly concerns persons and their dependents. Transactions on that market bear on types of contracts that differ from those for the exchange of goods or capital properties. Moreover the market is differently regulated. There is, however, something in common with other markets, namely a large traffic, involving in permanence new entries and exits of many suppliers and demanders, of labor services in its case, of goods or properties in the other two cases.

Concern for the persons employed or offering their service was the main motivation prompting labor laws since the nineteenth century. But consideration was also often given to the conditions under which the economy and society would prosper. Overall, present labor laws and regulations make the market more rigid and the transactions more complex than is the case for goods or capital. Correlatively the traffic is less intense, which is not always welcome. Indeed, a relatively flexible labor market has advantages for workers, who can expect to relatively quickly find a job, either for a first employment, or after unemployment, or still when they contemplate a change of job. A flexible labor market has obviously advantages for employers, as long as it does not generate workers' unrest or excessive tendency on their part to change jobs.

3.2 Employment, a major issue about structural policies concerning the labor market

Institutions of the labor market differ from one country to another and are subject to change as a result of what we call structural policies, which also concern modalities in the application of laws or conventions between social partners. Indeed structural policies about the labor market address a range of issues studied by labor economists, as well as by sociologists and lawyers.

In order to focus here my presentation of such issues I shall restrict attention in two ways. I shall first speak as if policies concerned just the choice of the

forms of, and degree of, flexibility in the labor market. I shall second pay attention only to the effect of policies on aggregate unemployment. You understand that those are substantial restrictions. But they may be justified by the observation that the trade-off between flexibility and unemployment was the main object of many discussions in Europe since the late 1970s. The question was then, and now remains, to know how much would employment suffer from, for instance, a given increase in the minimum wage or from a given regulation protecting workers against dismissal. We may say that in the European Union such questions were debated over and over again, so turning into obsessions among labor economists.

3.3 Many econometric investigations faced with difficulties

The main arguments in the debates bore on which conclusions should be drawn from econometric investigations about the effects of a long list of structural changes. It was early on clear that, in order to draw policy conclusions, empirical evaluations were needed about the many dimensions of the tradeoffs between flexibility and unemployment. Econometricians, all along the last twenty-five years in Western Europe, delivered their results. Unfortunately most of these results were not clear-cut enough to appear decisive in the debates opposing people with different views about the guarantees offered by labor regulations compared with the advantages of high employment.

Of course, the accumulation of results somewhat remedied the lapse of persuasiveness of the whole body of evidence. This will permit me in a moment to present my own conclusions. But, before doing so, I must speak about the origins of the econometric difficulties. They spring from both the institutional complexities of labor markets and the length of lags between a structural change and its effects, particularly on unemployment.

Many among the econometric studies to which I am alluding attempted to take advantage of international disparities in the structures of labor markets. Comparisons of these structures and of the concomitant employment performances are indeed informative. However, accurate comparisons would require internationally comparable characterizations of the structures in question. Given institutional complexity in each country, international comparability remains a true challenge. Poor comparability means that detection of effects of international disparities is blurred, hence imprecise. In fact we must express our thanks to research workers and statisticians who worked at overcoming the measurement difficulty, particularly to the OECD personnel who keeps providing sets of national indicators, precisely for what is interesting us now. Even so, comparability is far from perfect.

The second difficulty comes from the fact that effects of structural changes are slow to appear, because they concern structures to which workers and employers can seldom quickly adapt. The impediment is reinforced by the fact that unemployment is notoriously also slow to adapt to any change in its environment (economists often speak of unemployment hysteresis). Any econometrician studying a slow phenomenon is handicapped by the fact that such a phenomenon hardly ever operates alone. Its effects are mixed with other effects, which must then be simultaneously estimated. And this is an extra cause of imprecision.

Notwithstanding all that, econometric investigations went on and are still going on, looking to as much evidence as can be found. Focus is often placed on a particular institutional aspect, such as the level of the minimum wage or the degree of employment protection. Some of these investigations bear on a single country and concern the effects of such or such important structural change it experienced. In order to make global comparisons between countries, a synthetic indicator of flexibility has also been established. Econometricians looked whether those European countries in which unemployment decreased particularly quickly during the 90s then had particularly flexible labor markets.

3.4 Conclusions emerging from these investigations

It remains true today that empirical proofs about the problem I am now discussing are weaker than we could have anticipated twenty years ago if we had known that so much efforts would be spent. However, I consider that two relevant qualitative conclusions now emerge. In the first place, it seems that overall a high degree of labor market rigidity is detrimental to employment. As long as we agree, and I believe we do, that a fuller employment would have high value for our countries, it would be irresponsible to keep on quibbling and requesting stronger proofs before considering any structural reform.

In the second place, the empirical evidence does not select as being best a particular pattern of labor market structures. Quite the contrary, we see that several European countries succeeded in bringing back their unemployment rates close to 5 per cent without overthrowing the spirit of the structural pattern according to which their labor legislation and social policies had earlier been developed. Each one of those countries succeeded in increasing flexibility of its labor market in its own way. So, there seems to be a good deal of leeway in accommodating fair degrees of both economic efficiency and welfare.

This does not mean that defining and implementing a satisfactory program of labor market reforms is easy. Neither would it be easy to graph the leeway I just referred to. It clearly depends on the culture and historical experience of

each country. It is exposed to mistakes due to the uncertainty of our objective knowledge, as I tried to outline it. Saying more would require entering into details, a task which would go beyond the scope of this presentation. However, the research I described was overall clearly beneficial.

Before closing I feel, however, the duty to add a few words about wage policy. I shall not repeat here what I said in the first part of my presentation about the priority of labor over capital and about the excessive returns to capital which we experienced recently. Neither shall I recall discussions among economists about the responsibility that a too high level of wages could have had at times in the rise of unemployment. But being here close to the Mezzogiorno and noticing also the employment problem in the German Eastern Länders, I must call to mind the risk of historical mistakes when wages in a poor region were prematurely aligned with the wages in the rest of the country, far beyond what the relative levels of productivity would permit. Retrospectively it seems to have been a dramatically wrong policy, which for long locked parts of the region in their poverty.