

More competition means lower unemployment

Opening product markets up to competition has helped to reduce unemployment in many European countries, according to new research from the Institute for Fiscal Studies. This is especially true in those countries where unions are particularly strong.

The study by **Rachel Griffith, Rupert Harrison and Gareth Macartney**, which was presented at the Royal Economic Society's 2006 Annual Conference at the University of Nottingham, also finds that increased competition has raised workers' real wages. But in this case, the effect is smaller in highly unionised countries.

Rupert Harrison, one of the authors of the research, comments:

'Our results suggest that reducing barriers to competition in product markets may be just as important for reducing unemployment as reforming labour markets.

They also show that the presence of strong unions is not a good reason to shy away from product market reforms – if anything there is more incentive to reform as the employment benefits may be larger.'

Between 1988 and 1998, reforms that opened up markets and increased competition reduced unemployment across 14 OECD countries by just under one percentage point on average.

In the UK, the effect was to reduce unemployment by 1.3 percentage points compared with what it would have been without the reforms – accounting for almost one quarter of the total reduction in unemployment between 1988 and 1998. The effect on wages was an average increase of just over 3%, with a larger increase of 7.1% in the UK.

Most of the policy focus on reducing unemployment has been on removing restrictive labour market regulations and reforming benefit systems. But the idea that barriers to competition are an important factor in explaining high unemployment is part of the motivation behind much of the European Union's Lisbon Agenda, including the controversial services directive.

This research provides the first robust empirical evidence that past reforms that have reduced barriers to competition have indeed reduced unemployment and raised real wages.

Increased competition reduces unemployment by reducing the ability of businesses to keep prices high and reduce output. In countries with strong unions, it also reduces the ability of unions to bargain for high wages. Both of these effects tend to increase the number of jobs created and reduce unemployment.

Increased competition can have two opposite effects on real wages. Although more competition may reduce the size of wage increases that unions can bargain for, it also reduces the price of goods and services that workers buy.

The results of this research show that, overall, people generally gain more as consumers as a result of reforms than they lose as workers. But some workers may lose out if reforms only affect the sectors in which they work and not the products and services they consume.

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Notes to editors:

1. 'Product Market Reforms, Labour Market Institutions and Unemployment' by Rachel Griffith, Rupert Harrison and Gareth Macartney was presented at the Royal Economic Society's 2006 Annual Conference at the University of Nottingham, 18-20 April. For more information about the conference, contact Romesh Vaitilingam on 0117-983-9770 or 07768-661095 (email: romesh@compuserve.com).

2. The full paper can be found at <http://www.ifs.org.uk/wps/wp0606.pdf>

3. The research brings together data on the impact of reforms such as the European Union's Single Market Programme to investigate the relationship between reducing barriers to competition and unemployment and real wages over the late 1980s and 1990s. The types of reforms include lowering barriers to entry, reducing tariffs and other barriers to trade and reducing state involvement in the economy. The countries covered by the research include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Italy, the Netherlands, Norway, Portugal, Sweden, the UK and the United States.