PRODUCT MARKET REGULATION AND LABOUR MARKET OUTCOMES: HOW CAN DEREGULATION CREATE JOBS?

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Employment in service sectors now represents more than 60% of total employment in most OECD economies, and more than 68% in the United States, where it has accounted for most net employment growth since 1970. As the pace of post-industrialisation quickens, it is natural to expect growth in service employment to continue, as foreseen by Colin Clark, Jean Forastié, Simon Kuznets, and William Baumol, among others. Moreover, it is tempting to attribute the poor unemployment record of Europe over the past two decades to slow growth in tertiary sector employment, at least compared with the United States. The claim is often made that poor growth in services employment might be due to product market regulation, and deregulation is frequently mentioned as one potential remedy for the European unemployment problem.

In a service economy, one individual serves another. Thus even if one accepts that the service economy is the future of capitalism and an important part of any solution to Europe's unemployment problem, an expansion of service employment comes at the cost of increased fragmentation or disconnection of individuals available social free time to spend in leisure with others. This is especially true of consumer services. In the U.S., a quarter of all employment is in the retail and wholesale trade sector alone, a sector involved in *selling* in the strict sense, and one which Americans generally associate with leisure. If one includes restaurants, hotels and personal services more generally, the fraction rises to well above 35%. An expansion of employment in service activities is necessarily associated with an increase in the *disconnectedness* of society, meaning a decrease in the coordination of its members' private activities. Harvard political scientist Robert Putnam has invoked the image of "bowling alone" to describe what he sees as a secular decline in communal and social activities conducted jointly with others.

Seen in this light, the regulation of service-providing sectors could be regarded as an attempt to coordinate leisure and internalise positive externalities which arise from resting or enjoying free time collectively. The external effect might apply to members of an immediate family as well as to a community or nation at large. Not only will the free market tend to undersupply coordination, but will generally provide ample incentives to undermine it: when the majority of the population is resting, the value of labour supplied to the market is likely to be high, and coordination may not be a stable decentralised equilibrium. At the same time, however, synchronisation of society's leisure time can involve large employment costs that must be put in the balance. A store forced to close early suffers from excess capacity, since real capital assets (floor space, inventory, check out counters, cash) are not fully utilised. Regulations of this sort are widely suspected of repressing the development, if not the absolute level, of output and employment in retail trade, banking and other personal service sectors. They may affect the labour force participation of females by restricting the availability of part-time jobs. These efficiency losses must therefore be balanced against the putative advantages of coordinated leisure and other public policy objectives. While desynchronisation of retail hours and production schedules reduces congestion in stores and makes shopping more convenient, it does so at the cost of reduced coordination of leisure.

Expanding service employment increases the *disconnectedness* of society, but synchronisation of leisure time has employment costs

In the context of European unemployment, one is also concerned with the macroeconomic effects of opening-time regulation on the quantity and the

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Dutch Miracle? Evolution of services employment as percent of total employment and percent of total resident population, 1985–1995

	Germany		Netherlands		USA	
	1985	1995	1985	1995	1985	1995
Wholesale and retail trade, restaurants and hotels	15.9 (6.9)	16.9 (7.5)	16.8 (6.0)	19.6 (8.7)	21.8 (10.0)	21.8 (10.5)
Transport, storage and communication	5.8 (2.5)	5.8 (2.6)	6.3 (2.2)	5.9 (2.6)	5.4 (2.4)	5.4 (2.6)
Financing, insurance, real estate and business services	7.1 (3.1)	9.9 (4.4)	10.4 (3.7)	12.9 (5.8)	10.1 (4.6)	10.8 (5.2)
Community, social and personal services	24.6 (10.7)	26.9 (12.0)	32.2 (11.5)	31.1 (13.9)	30.5 (13.9)	34.3 (16.5)
Total	53.3 (23.2)	59.6 (26.5)	65.7 (23.5)	69.6 (31.0)	67.8 (30.9)	72.3 (34.7)

Source: Statistical Compendium of the OECD, 1998, author's calculations.

quality of employment. The impact of a relaxation of trading restrictions will include its potential for creating part-time, flexible employment for large numbers of people. Casual observers of recent developments have marveled at the precipitous declines in unemployment in the United Kingdom and especially the Netherlands in recent years. Less noticed is the role that services, and the retail sector in particular, have played in this development. Consider that wholesale and retail employment in Holland grew by 63.1% between 1985 and 1995, or 4.6% per annum; over the recent period 1995–1997 this sector's employment grew by another 7%. In Germany, retail employment grew between 1985 and 1995 by 26.3% or 2.1% per annum; over the period 1995–97 it shrank by 1.5%! A similar picture emerges in the banking and financial services sectors. This conspicuous difference cannot be attributed to overall GDP growth in the two countries, which was rather close (2.7% in Holland versus 2.3% in Germany). The table above shows that the Netherlands – which has undertaken a number of product and labour reforms in the past decade, including the deregulation of retail opening hours – is moving more rapidly than Germany towards the leader in service employment, the United States.

Shop closing laws may increase welfare, but can suppress employment and value added

These issues may be analysed in terms of a class of model proposed by Burda and Weil (1999). In these models, shop closing regulations affect employment, wages, productivity and the relative price of retailed goods because people are not indifferent about when they take their leisure. In general equilibrium, stricter regulation will tend to reduce hours worked in both goods producing and retailing sectors as well as output in these sectors and may impose an "anti-retail bias" on employment. Moreover, shop closing laws can affect relative prices and increase retail prices by increasing the capital (inventory) intensity of retailing, and possibly reducing retailed output and increasing its relative price.

The model clearly identifies generalisable "negative" effects of this form of product market regulation: it can suppress employment and value added. If the state is acting optimally in the interests of its citizens, shop closing laws can nevertheless be welfare-increasing. In this sense, the model draws attention to observable implications, which can be useful in clarifying policy discussions. Moreover, while the theoretical model does not always generate unambiguous results, it robustly rejects Stützel's Paradox – that value-added in retail is invariant to shop opening times.

The analysis of this paper suggests that shop closing regulations may be a high price to pay for societal coordination. They have large efficiency costs and may mean fewer jobs as well as an inefficient retail sector; they also force a concentration of purchases over a shorter time interval with the effect of more labour input and less material input per unit of value added produced, even though the result may be less activity in the sector (allocative inefficiency). Deregulation comes at the cost of less leisure coordination but implies more privately efficient levels of staffing and lower wages. One modest contribution of this paper would be to bring these considerations, as well as the modest empirical evidence which is presently available, more clearly to the attention of policymakers.