Our analysis shows how coordination of labour market policies can lead to:

- **Increased welfare**
- **Reduced opposition**
- **Efficient allocation of resources**

If governments maximise welfare, the net externality they impose on the other country results from coordination. The question arises under which circumstances coordination can benefit the cooperating partners.

Why is there so little coordination of labour market policies? The European Union (EU) would be a prime candidate for policy coordination. The importance of cooperative action over labour market policy has been partly recognised by the Amsterdam Treaty. However, in reality, coordination remains weak.

### The Literature

- **Limited w.r.t. labour market coordination** (Franzese and Hays, 2006).
- **Strategic trade** / Production Subsidies (Brander and Spencer, 1984; 1985).
- **Coordination of international commodity taxation** (Moriconi and Sato, 2009).

### Our Paper

- We look at the effect of wage subsidies in an international duopoly model with unionised labour markets, unemployment benefits, and product market imperfections.
- We derive the costs and benefits from policy coordination on a centralised level (such as the European Union).
- We introduce asymmetric labour market institutions (differences in unemployment benefit systems).
- We analyse the effects of governments pursuing an employment target instead of a welfare target.

### Our Findings

- Wage subsidies affect labour and profit income, employment, and consumer surplus both at home and abroad.
- If governments target employment instead of welfare, they only take a subset of these effects into account when deciding about the optimal wage subsidy.
- If governments maximise welfare, the net externality they impose on the trading partner is positive and negative if they target employment.
- If labour markets are symmetric coordination is always beneficial.
- With asymmetric labour market institutions coordination restrictions the capability to account for national institutions. In addition, the gains and losses from coordination are unevenly distributed. In fact, the welfare gap between countries may even widen through coordination.

Our analysis shows how coordination of labour market policies can lead to severe opposition and gives a rational why labour market policies are still widely pursued in national hands.

---

**The General Question and Motivation**

- What is the effect of labour market policies in a globalised world?
- Labour market institutions interact across national boundaries if product markets are global (Davis, 1998) and hence labour market policies entail spill-over effects between countries.
- What are the costs and benefits from policy coordination?
  - In the presence of policy spillovers, there can be benefits from policy coordination on a centralised level. The question arises under which circumstances coordination can benefit the cooperating partners.
- Why is there so little coordination of labour market policies?
  - The European Union (EU) would be a prime candidate for policy coordination.
  - The importance of cooperative action over labour market policy has been partly recognised by the Amsterdam Treaty.
  - However, in reality, coordination remains weak.

---

**The Details**

### The Model

- **Static international duopoly model** (based on Naylor, 1998) with endogenous wage setting and employment.
- Two countries (Home and Foreign (*))
- Symmetric consumers and producers.
- **Timing of events:**
  - **Set Subsidies (Gov.) →** Set Wages (Union) → Output/Employment (Firms)

### The Effects of Wage Subsidies in Home and Abroad

- **Home Economy:**
  - An increase in s will...
  - ...increase consumer surplus, profit income, domestic wages, and employment.
  - **Foreign Economy:**
  - An increase in s will...
  - ...increase foreign consumer surplus
  - ...decrease foreign profit income for \( e > 0 \)
  - ...decrease foreign wages and employment for \( e > 0 \)
  - ...decrease foreign taxes for \( e > 0 \)

### Coordination vs. Autarky

- **Non-cooperation:** Governments decide independently about \( s \) and \( s^* \) to maximise \( W \) and \( W^* \), respectively.
- **Coordination:** Governments choose common subsidy level \( s = s^* \) to maximise joint welfare \( W + W^* \).
- The optimal subsidy under cooperation is strictly higher than under non-cooperation.
- The welfare gain from cooperation is nonnegative and strictly decreasing in \( e \).

### Labour Market Asymmetries

- We consider the case of \( b > b^* \).

---

**Contact:** Christian Spielmann, Birkbeck College, University of London and Institute for the World Economy, Kiel

email: cspielmann@ems.bbk.ac.uk