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Lindbeck, Assar, Unemployment and Macroeconomics. Cambridge, Mass. and London, England (MIT Press) 1993, XI, 201 pages, index, $ 29,95.

Due to the well-known figures on the persistent underutilization of labour for many countries, especially in Europe, the analysis of unemployment continues to be at the top of the research agenda of macroeconomists. The associated inefficiencies, both in production and distribution, of prolonged spells of unemployment for a good part of the labour force easily dwarf the implications of most other economic or more general social problems – with the only obvious and undisputed exception of wars. Thus, an up-to-date and (mostly) non-technical survey of the main empirical and theoretical developments by one of the leaders of the subject is highly welcomed. Assar Lindbeck's book, which is a revised version of his November 1989 Ohlin Lectures at the Stockholm School of Economics, provides this service for economists who are acquainted with the broad lines of macroeconomic research, but nevertheless feel a need for a refresher course on this issue. For specialists in the field the book is required reading, especially because of the way, policy conclusions are drawn from available theory. However, with the possible exception of the second chapter which gives an empirical overview, the book is to be recommended only for readers who already have some familiarity with macroeconomic theory.

Lindbeck's approach is the analysis of a non-equilibrating labour market in the sense that labour demand and labour supply do not (generally) coincide at the prevailing wage rate. Nevertheless, the analysis is carried out entirely in the spirit of neoclassical economics. The solution to this apparent contradiction is achieved by a distinction between two concepts of labour supply: Firstly, the wage-setting curve WS reflects union power and the like (and together with labour demand LD determines real wages and employment). Secondly, the full employment curve depicts the number of individuals willing to work at a given wage. The latter curve is drawn vertically in the real wage-employment space for lack of information on the dominance of income and substitution effect. Thus (at least) labour supply is organised in a non-atomistic way. Of course, full employment is an outcome which appears only by accident in such a setting. In general, full employment is not supported by wage-setters. Given this perspective, the central theme of the whole book is the discussion of the WS and LD curves.

The organization of the book follows the common scheme: Facts (chapter 2) – Theory (chapters 3–7) – Policy (chapter 8). After a short introduction, the discussion starts in chapter 2 with the presentation of "The Empirical Picture", which emphasises both cross-country and longitudinal evidence. The first heading in this chapter conveys the shift of the challenge for macroeconomic labour market theory, that occured during the last two decades: "Business Cycles Versus Unique Historical Events". Whereas ordinary business cycles are of declining (empirical) importance since World War II and theoretically well mastered, the "unique events" are at the core of the analysis, since the evidence points to long-lasting or persistent effects of such shocks. Current theorizing on the subject may well be characterised as a search for channels which explain, e.g. why a well-defined (and for the short run well-analysed) import-price shock in the 1970s may exert pressure on the labour market in the 1990s.

Chapter 3 surveys some alternative explanations (or to name it after the fashion: microfoundations) for the existence of non-market clearing wages, with special attention to the insider-outsider theory of unemployment. Whereas this emphasis is clear from Lindbeck's own research in the past decade[1]), it is never a seriously biased exposition of the existing body of literature. Here one omission has to be mentioned: In the last few years, there has been an increasing amount of literature on the flow-approach to labour markets, which extends the seminal work of Hall (1979). One might come to the *conclusion* that this strand of research can barely explain much of the intertemporal variation of unemployment rates; but it comes as a surprise, that in the book under review nothing at all is said about it.

The basic model underlying the entire discussion in this book is presented in chapter 4. Its flavour has already been described; it obviously is in the spirit of the approach developed at the London School of Economics and extensively documented in Layard/Jackman/Nickell (1991).

A so-called innovation of Lindbeck is the concept of the QERU (quasi-equilibrium-rate-of-unemployment, see also Lindbeck 1992), which is defined by the intersection of the wage-setting curve and the labour demand schedule, and thus pins down a stable real wage. The relation of the QERU to the more familiar NAIRU (non-accelerating-inflation-rate-of-unemployment) is as follows (p. 68): Whereas the QERU demands only the constancy of the real wage, the NAIRU is defined by the slightly more demanding condition that both nominal wage growth and price inflation are constant. Thus the NAIRU is a special case of the QERU. In the opinion of this reviewer, the distinction between QERU and NAIRU is of limited use, since it tends to confuse rather than emphasise the basic message of the Phillips-curve: Inflation consists of an expected part (core inflation) and a part that depends on variables, which may be summarised by the state of the labour market. Of course, for a given unemployment rate, inflation expectations may shift. That is the whole point of the QERU, and thus the new acronym may rather add to the reputation of the NAIRU concept as "not always instructive rate of unemployment" (Drèze 1987, p. 27) than to the

[1]) The most important papers are brought together in *Lindbeck/Snower* (1988).

clarification of analytical issues. To be sure, Lindbeck's book has nothing to say about inflation determination that is related to the first of the above mentioned parts.

A very useful discussion of supply shocks and demand shocks in terms of the WS-LD-model is presented in chapters 5 and 6. The analysis of supply shocks in chapter 5 includes the usual list: shocks to technology and import prices; unemployment benefits; increasing union militancy and tax burden. Chapter 6 recalls the various transmission mechanisms of demand shocks to the labour market: In traditional Keynesian economics, an adverse demand shock in the goods market simply reduces output and employment, thereby *increasing* the real wage in the course of a (leftward) movement along a downward sloping labour demand curve. Lindbeck also considers the possibility of horizontal or even upward sloping labour demand curves, a case which can easily arise in the presence of idle capacity during the beginning of an upswing, when constant or increasing returns to scale are present. Another consequence of a demand shock may be a shift of the labour demand schedule. Here, Lindbeck carefully considers the possible underlying reasons for this shift and goes well beyond the usual assumption of demand-level related market power of individual firms. In addition to this channel, government investment in infrastructure, the entry of new firms and usage of formerly idle capacity are candidates, which may explain a rightward shift of the labour demand schedule after an expansionary demand shock.

Chapter 7 reviews several by now well-known channels which are especially tailored to explain unemployment persistence. The most interesting point in this section is a comparison of the effects of persistence mechanisms (Lindbeck considers labour turnover cost, but the argument is applicable to other channels as well) during ordinary cycles and prolonged recessions: In the former case, employment may be (welfare enhancing) smoothed by the presence of persistence, whereas in the latter case, as soon as lay-offs are executed, the way back to more employment is asymmetrically prolonged.

In chapter 8, Lindbeck summarises the main points and and applies his analysis to real world examples. Especially interesting is his account of the celebrated Swedish labour market performance. Contrary to convential wisdom about this experience, Lindbeck does not give any credit to the centralised (corporatist) structure of the wage bargain and only little to active labour market policy and the strict administration of the unemployment benefit system. His preferred exogenous variables are devaluations (which led to a fall in the real product wage) and increases in public sector employment.

Whereas he tells a convincing story, the argument between the two competing views of the Swedish experiment has to be settled empirically, of course.

Lindbeck escapes the temptation to draw simple conclusions from complex contexts, and thus, the policy lessons to be learned are not easy to tell a politician. Emphasis is given to the weakening of the insiders relative to outsiders, but the intertemporal consequences of many policies turn short run effects upside down in the long run. For example, expansionary fiscal policy may have contractive effects, if the repercussions from movements of the exchange rate and interest rate are taken into account.

It is one of the most important achievements of this book, that the reader learns about such difficulties from a cautious rather than a negligent or fatalistic point of view.

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