Labour Market Reforms and Youth Unemployment

3.1 Introduction

High and rising unemployment rates over the last few years have drawn attention to the functioning of labour markets in European countries and the need to reform those institutions and policies that affect them. Arguments for reform are partly driven by the immediate need to reduce public borrowing, particularly in Greece, Spain, Portugal, Ireland and other countries with public debt problems. They are also driven by the need to rebalance demand towards those countries, which have become uncompetitive, have been running persistent current account deficits and now have high unemployment. Meanwhile in the background there are the long-term objectives of improving the way that these markets work, lowering the structural unemployment rate, making labour markets more shock-resistant, and giving economies greater scope for growth in the future.

This chapter examines the interactions between the different institutional characteristics of labour markets in Europe, and the impact of the current recession on their unemployment structure and dynamics.

Section 3.2 sketches the wide variety of unemployment experiences across countries in recent years, while Section 3.3 discusses the motivations for and effects of the existing configuration of labour market institutions, and possible reforms to them. Section 3.4 looks at youth unemployment, vocational training and apprenticeships. Section 3.5 traces the impact of crisis on the resulting heterogeneous labour market configurations and discusses current pressure for reform in problem countries; and Section 3.6 concludes by reviewing desirable reforms and their potentially problematic features.

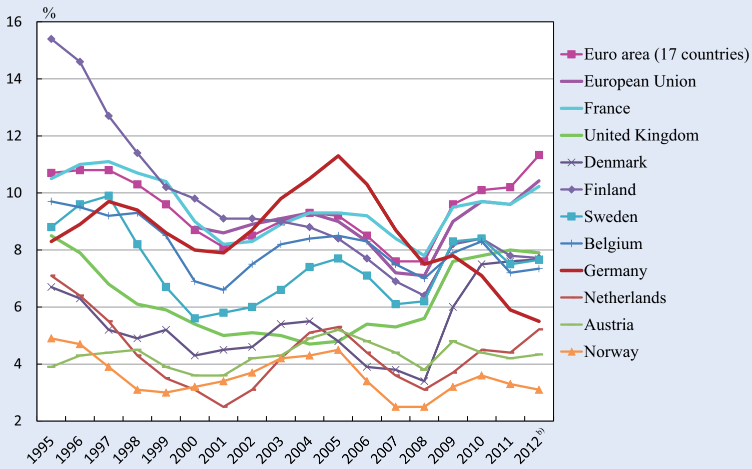
3.2 Unemployment rates[1]

As shown in Figures 3.1 and 3.2, aggregate unemployment in the European Union was 7.2 percent in 2007, and rose to 10.4 percent in 2012; while in the euro area, it rose from 7.6 to 11.3 percent over the same period. These changes (if not the levels) are comparable to those seen in the United States, where unemployment rose from 4.6 to 8.1 percent over the same period. Within the European aggregates, however, there are wide differences between countries as regards not only the overall unemployment rate, but also the level and changes in its long-term and youth components. Most relevant and striking is the contrast between the countries (Greece, Spain, Ireland, and Portugal) with the most serious debt sustainability issues and those countries that did not suffer from the resulting high interest rates and restrictive fiscal policies. Between 2008 and 2012, unemployment increased from 7.7 to 23.7 percent in Greece, from 8.3 to 25.0 percent in Spain, from 4.6 to 14.9 percent in Ireland and from 8.5 to 15.7 percent in Portugal; over the same period, aggregate unemployment has actually fallen from 7.5 to 5.5 percent in Germany, and risen only slightly in the Nether-

[1] There is a small discrepancy between the figures quoted in this chapter and Chapter 1 because the sources are different and the basis of the calculations differ slightly.

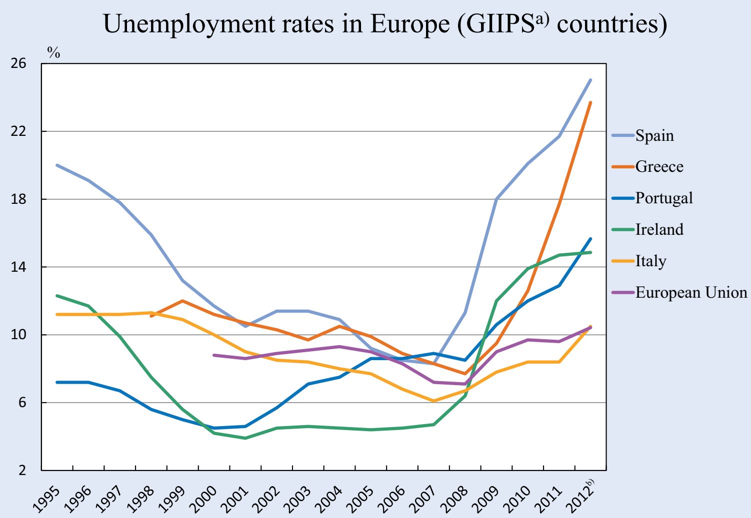
Figure 3.1

Unemployment rates in Europe (excl. GIIPS[a)] countries)



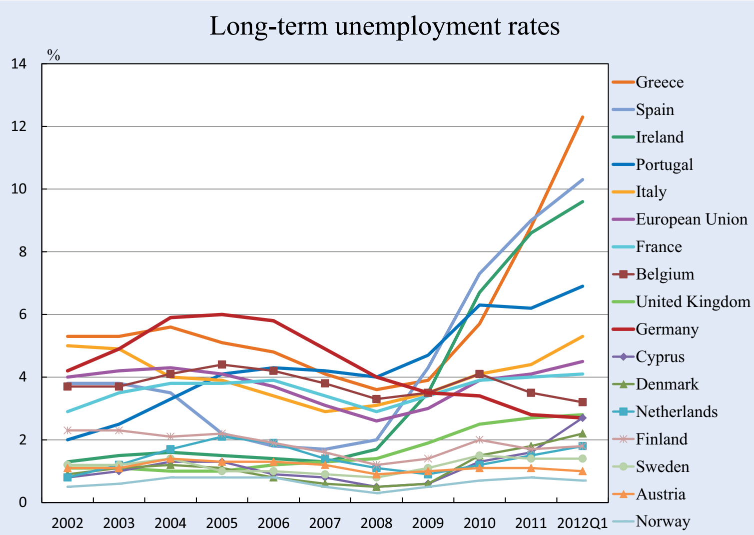
[a)] Greece, Ireland, Italy, Portugal and Spain. [b)] Average of the first nine months for Norway and United Kingdom, average of the first eleven months for all others.
Source: Eurostat (une_rt_a).

Figure 3.2



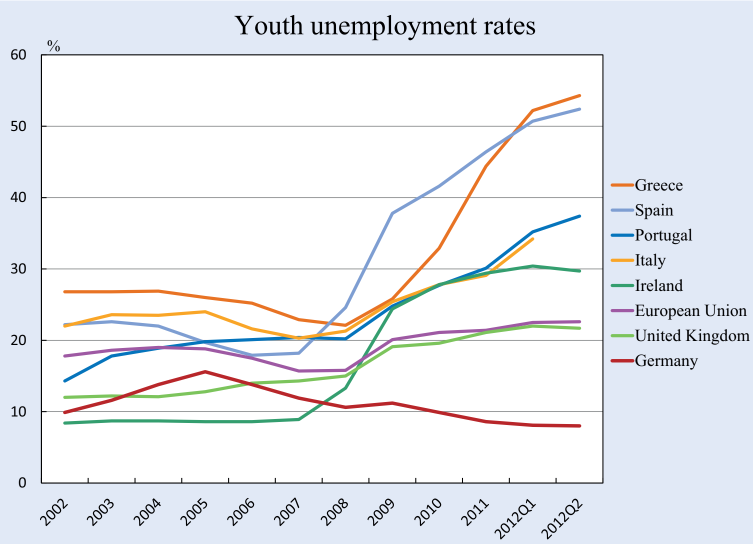
a) Greece, Ireland, Italy, Portugal and Spain. b) Average of the first eleven months.
Source: Eurostat (une_rt_a).

Figure 3.3



Source: Eurostat (une_ltu_a, une_ltu_q).

Figure 3.4



Source: Eurostat (une_rt_a, une_rt_q).

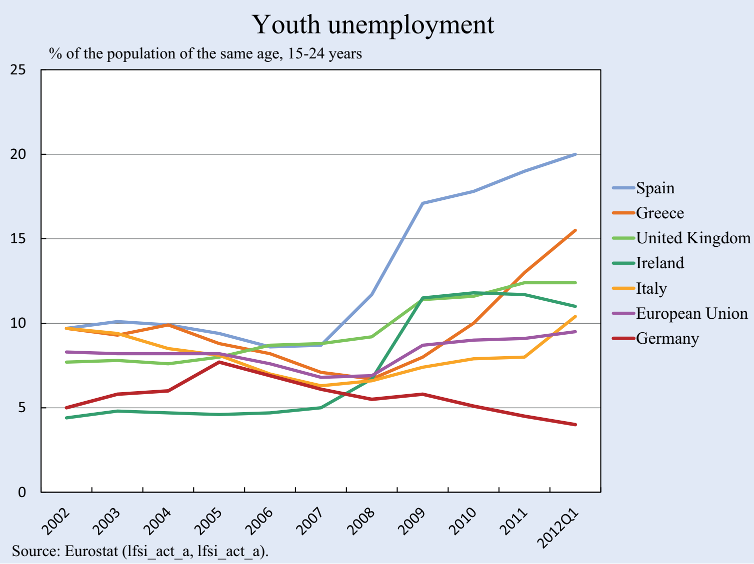
lands (from 3.1 to 5.2 percent), Austria (from 3.8 to 4.3 percent), and Finland (from 6.4 to 7.7 percent). The data for other countries lie in between, and are not as clearly related to debt sustainability issues (as for example Italy's unemployment rate, which increased from 6.1 to 10.5 percent and that of Denmark, which rose from 3.4 to 7.7 percent).

Figure 3.3 shows that long-term unemployment, defined in Europe as the percentage of the active population that has been unemployed for over a year, has also grown considerably, following much the same pattern and rising (to 12.3 percent in Greece, 10.3 percent in Spain, 9.6 percent in Ireland, 6.9 percent in Portugal) in problem countries, but remaining low (2.7 percent in Germany, 1.0 percent in Austria, 1.8 percent in the Netherlands) in countries that recovered quickly from the Great Recession. Other countries again offer a varied picture, with long-term unemployment low in Denmark (at 2.2 percent), but higher in Italy (5.3 percent) and France (4.1 percent).

Youth unemployment rates (for persons aged 15 to 24), shown in Figure 3.4, now lie in the range of 30–55 percent in Greece, Spain, Ireland, Portugal and Italy. Those numbers actually make the youth unemployment problem look worse than it really is, as only a small fraction of the population of persons aged 15–24 is in the labour force, and most are in education or training. As Figure 3.5 shows, youth unemployment as a percentage of the population rather than the labour force is high, but less alarming.

Actual unemployment rates can be considered as the sum of two

Figure 3.5



Source: Eurostat (lfsi_act_a, lfsi_act_a).

parts. Firstly, structural unemployment is the rate that would emerge if the economy were not hit by shocks to demand or supply, if inflation were held at a low steady rate, and the economy grew smoothly. Secondly, cyclical unemployment, the remainder, results from shocks: like the boom in real-estate in some countries and in a wider range of financial assets in others between 2001 and 2007; and the collapse of demand since 2008.

How much current unemployment is structural? Some recent estimates produced by staff of the OECD and the European Commission are given in Table 3.1. The OECD estimates for 2007 range from 3.8 percent for the Netherlands, 4.2 percent for Denmark, 4.7 percent for Ireland, 4.9 percent for Austria, 5.1 percent for Sweden and Spain, up to 8.4 percent for Germany and 9.8 percent for Greece. Structural unemployment rates change over time, and they cannot be estimated with much precision, as the standard errors reported in Table 3.1, column 2, indicate. European Commission estimates for 2010 show large increases for some countries, particularly Spain, Portugal and Ireland, which have had large increases in actual unemployment. In general, however, these estimates show, unsurprisingly, that current unemployment contains a large cyclical component for most European countries. Germany, whose current unemployment rate lies well below the structural rate, is the notable exception. The countries that have had to apply the severest "austerity" policies, namely Ireland, Portugal, Spain and Greece, have (again, unsurprisingly) the largest rates of cyclical unemployment, as well as high structural employment.

Table 3.1

Estimates of structural unemployment rates[a)]

	Non-accelerating inflation rate of unemployment (NAIRU)	Standard error of NAIRU estimate	Non-accelerating wage rate of unemployment (NAWRU)
Year of estimate	2007		2010
Austria	4.9	0.30	4
Belgium	8.0	0.87	8
Denmark	4.2	0.66	5
Finland	7.0	0.93	7
France	8.3	0.71	10
Germany	8.4	1.09	8
Greece	9.8	0.54	–
Ireland	4.7	0.48	12
Italy	6.4	1.30	8
Netherlands	3.8	0.45	4
Portugal	6.9	0.99	12
Spain	5.1	–	16
Sweden	5.1	0.80	7
United Kingdom	5.3	0.45	8

a) Unemployment rate measured in percent of labour force.

Source: Gianella (2009), Orlandi (2012).

3.3 Motives for and effects of labour market regulation and reform

The labour market institutions that have been the subject of reforms in the recent past and are candidates for further change now are: the system of unemployment and other social security benefits; the system of wage determination, including unions and collective bargaining; employment protection legislation; minimum wages; the tax wedge; active labour market policies; and vocational training and apprenticeships.

Some structural policy changes permit lower public spending and higher tax revenue. Such changes combine a short-term budgetary saving with a possible long-term reduction in structural unemployment. However, they are highly contentious: some people are made clearly worse off by them in the short-term, even if many people stand to gain eventually. Cutting unemployment benefits, increasing the retirement age, cutting minimum wages, reducing severance payments or periods of notice for dismissals, for example, clearly go against the short-term interests of workers and the unemployed; they impoverish people who are already low down in the distribution of incomes. "Smart" policy changes that assemble combinations of elements may be able to compensate people who suffer losses from the effects of some of the policy elements with gains from others, and find more support.

3.3.1 Motives for intervention in labour markets: broad principles

Efficient allocation and reallocation of employment usually requires effort by workers, for whom changing jobs is costly. In laissez-faire labour markets such efforts need to be prompted by wage variability across more or less productive workers and jobs. Since it is difficult and important for individuals to be sheltered from the excesses of such variability, labour market institutions aim at reducing ex post inequality of outcomes for ex ante similar individuals, and/or at redistributing resources across different individuals. At the same time, they may affect aggregate employment and output negatively: higher wages reduce employment demand; non-employment subsidies reduce labour market participation and search effort; employment protection legislation and institutional wage compression reduce the efficiency of labour (re)allocation. To reconcile flexible reallocation and work incentives with the objective of sheltering labour incomes from risk, public training programs, in-work subsidies, and other active labour market policies combine forms of income support with measures meant to ensure that labour is not idle (as it might be in a simple unemployment benefit program) or employed in low-productivity jobs (as employment protection tends to imply). Such policies can combine "security" with "efficiency", but imply a third "fiscal" aspect of a policy trilemma: high levels of employment and security may be achieved at the same time only by committing sizable resources to the funding of labour market policies.

Some countries lean towards activation, others towards welfare support; some have emphasised security, others incentives and opportunities. The pros and cons of the systems depend on their socio-economic characteristics. A tighter family structure can, for example, make youth non-employment more acceptable as the price of job security and high wages for older workers. Of course, there need not be clear cause and effect relationships between the two features of different countries. It may be that the poor job-finding prospects are effectively what keep youths attached to their families of origin. Complementarities between these and other characteristics of different labour markets and societies should nevertheless be kept in mind when advocating the adoption of different institutional frameworks.

3.3.2 The role of collective bargaining and restrictions on competition

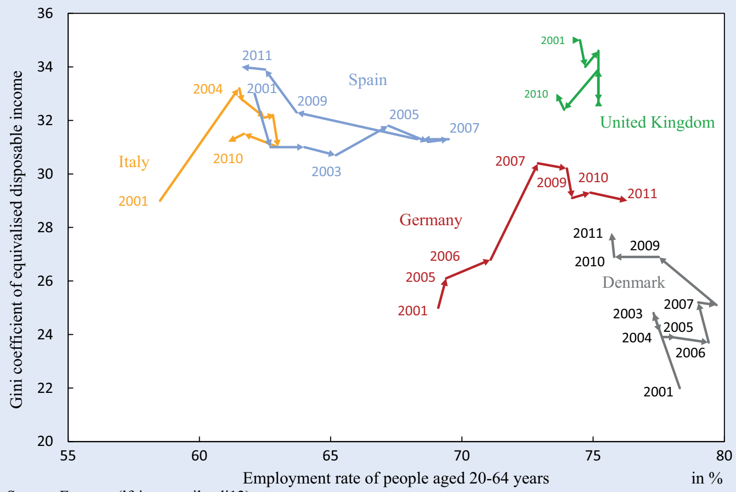
While the benefits of competition are widely recognised in goods and services markets, collective wage bargaining is exempted from anti-trust rules even in the United States, where Section 6 of the 1914 Clayton acts exempts labour unions and agricultural organizations because "the labour of a human being is not a commodity or article of commerce". Higher and more uniform wages are obviously appreciated by workers, even if they come at the cost of lower employment, production, and profits, because working households do not have access to a perfect financial market where labour income can be traded.

Restraints on wage competition can allow employers to finance their apprentices' general human capital accumulation without fearing that a trained worker will be head-hunted by higher wage offers (Acemoglu and Pischke, 1999): this increases production efficiently in cases where financial constraints would prevent workers from funding their own training, or indeed mobility towards more productive jobs (Bertola, 2004). Unemployment benefits and employment protection can also be beneficial if, by providing a safety net financed by society or by employers, they encourage workers to take individual risks that increase average production (Sinn, 1995).

The balance between the costs and benefits of labour market policies depends on the environment in which they operate. In recent decades (characterised by globalization, information technology progress, and macroeconomic stability), for instance, acquiring general skills and the ability to adapt to new technologies and perform new jobs in flexible, evolving labour markets were often viewed as advantages of the Anglo-Saxon approach to labour market mechanisms. The strong performance of other systems during the crisis may lead to a reassessment of this view: the jobs-for-life promise of Germanic systems of vocational education and tightly regulated occupational and wage-setting schemes seemed obsolete a short while ago. However, a crisis that revealed the shortcomings of flexibility and financial markets undoubtedly increased their appeal. Practical implementation of specific policies, however, must also be aligned with the socio-economic features of the countries involved: attempts by the United Kingdom and France to introduce apprenticeship type vocational training schemes encouraged by the German example have met with little success.

Figure 3.6

Employment rates and inequality across countries and over time



Source: Eurostat (lfsi_act_a, ilc_di12).

3.3.3 Inequality

Labour market rigidities not only reduce production efficiency, they also stabilise and equalise labour incomes. While international competitiveness requires labour market flexibility, workers certainly dislike insecurity. Bertola (2010a) finds that European Monetary Union (EMU) countries experienced substantially faster deregulation of their product markets and some deregulation of their labour markets. As a result, employment grew and unemployment declined everywhere, and more strongly where economic integration was tighter. In fact, changes to labour market institutions now account for all of the increase in inequality that the data also associate with EMU (Bertola, 2010b). As rigid labour markets could not cope with the internationalization of production, their increasingly unpleasant unemployment implications were addressed not only by deregulation, but also by the vigorous development of financial markets in the 1990s and early 2000s.

Labour market reforms are almost always painful. Regulations that keep primary workers' labour income high and stable, while typically making it difficult for youth to find employment, can lower household income inequality. However, Figure 3.6 shows that employment has been higher in countries with low inequality. This may reflect persistent socio-economic differences between Mediterranean and Scandinavian countries, for example. However, inequality grew in Germany between 2005 and 2009, as employment grew. In Italy higher inequality was also associated with higher employment. In Denmark, by contrast, inequality rose while employment fell. The general tendency for inequality to rise is probably due to the nature of changes in technology, but labour market deregulation and the introduction of low-wage employment opportunities, may have contributed to it.

3.3.4 Institutions and reforms

Institutions and policies affect labour markets in many different ways, and many detailed features of them are important. Reducing them to a small number of summary indices is a hazardous task. This is nevertheless attempted by the OECD in a bid to show how institutions have changed over time and differ between countries. Tables 3.2, 3.4, 3.6 and 3.7 report a selection of the most important indicators in 1997 and 2005 to show how things changed in the years leading up to the financial crisis.

3.3.4.1 Unemployment and other social security benefits

The OECD data in Table 3.2 summarise the benefits system with measures of the gross and net replacement rates: the ratio of benefits to earnings before tax, and after tax respectively, for an average worker. There is a striking contrast between the low

Table 3.2

Unemployment benefit replacement rates

	Gross replacement rates		Net replacement rates	
	1995	2007	2001	2007
Austria	32.5	31.6	60.4	59.6
Belgium	38.7	40.0	62.4	63.6
Czech Republic	5.9	6.3	22.0	29.4
Denmark	64.9	47.7	68.0	66.0
Finland	35.8	34.1	65.6	61.4
France	37.4	39.0	60.5	56.8
Germany	26.3	23.7	65.1	63.0
Ireland	26.3	37.2	42.7	53.8
Italy	19.3	31.7	5.6	7.5
Japan	10.2	7.6	9.6	11.9
Netherlands	52.3	33.9	60.0	38.9
Norway	38.8	33.6	74.0	75.9
Poland	11.5	10.2	36.3	40.3
Portugal	35.4	43.4	42.7	48.1
Slovakia	11.7	8.3	34.8	12.5
Spain	39.0	35.9	39.5	39.2
Sweden	26.9	32.4	44.3	42.8
United Kingdom	17.8	12.1	53.6	58.0
United States	11.9	13.6	5.6	5.6
OECD average	28.0	26.4	44.5	43.5

Source: OECD Employment Outlook 2012, Table 2.A1.4, http://www.oecd.org/els/employmentpoliciesanddata/EMo%202012_Chapter%202-Annexes%202.A1%20and%202.A2.pdf.

net replacement rates in the United States and Japan, and those in many European countries. Three Nordic countries have high net replacement rates, as may be expected: 66 percent in Denmark, 61.4 percent in Finland, and 75.9 percent in Norway in 2007. The rate in Sweden, however, is relatively low, at 42.8 percent, since Sweden was forced to scale back benefits in the early 1990s after a major recession, caused by a banking crisis, and a collapse in demand raised unemployment to double-digit levels, making the previously very generous system unsustainable. Pressure on public finances forced a retreat from the previously successful “Swedish model”. Other countries have similarly generous regimes, including Austria (59.6 percent), Belgium (63.6 percent), and Germany (63 percent).

The German case illustrates the problem of obtaining a full picture from summary figures. Germany’s landmark Hartz reforms, which are credited with having transformed German labour markets, were introduced between January 2003 and January 2005, but they do not show in the OECD data. While they covered a wide range of labour market issues, changing the benefits regime was a key aspect of them. Importantly, they combined the previously-existing unemployment assistance and social assistance into a new “unemployment benefit II”; introduced a system of tighter qualifications for receiving benefits and sanctions for not meeting them; widened the range of acceptable jobs that the unemployed could be required to take; lowered the marginal tax rate effectively applied to earnings of recipients in order to encourage the take-up of work; and introduced payments for community work. These reforms reduced the very high replacement rates that had been a feature of German social security for many years, and reduced the duration of benefits.

Labour market reforms always face difficult trade-offs. The Hartz reforms were prompted by the competitiveness pressures induced by the country’s reunification and European economic and monetary unification. While some measures were intended to increase overall productivity (for example, “workfare” rules made it possible to activate some poverty-trapped labour by allowing workers to retain a portion of their benefits when taking up work), the brunt of the reform induced wage moderation. Specifically, smaller benefit entitlements, in the absence of a legal minimum wage, strongly increased the supply of low-skill and de-unionised labour, and brought down unemployment by allowing workers to bid down the low end of wage distribution. Hence, higher employment came at the price of somewhat lower and far greater inequality as far as wage incomes are concerned (Eichhorst, 2012; Burda and Hunt, 2011; Dustmann et al., 2009).

While some countries have responded to the fall in the demand for labour largely by cutting the numbers of workers employed, others have spread out the cuts by shortening working hours. When labour demand fell in Germany in 2009 working hours were reduced, partly by using the Kurzarbeit scheme in the social security legislation, but mostly by employers using the flexibility in labour agreements to modify working hours within quite broad parameters for periods of up to three months and in some cases a year. In Italy firms have made use of similar provisions that subsidise shortened working hours through the social security system, resulting in a smaller rise in unemployment. In the United Kingdom short-time working has been accepted by unions and workers as a means of preserving jobs, without any particular scheme to provide incentives via social security contributions. In Denmark, firms used their flexibility to cut jobs rather than hours very quickly after 2008. In Spain and Portugal tight restrictions on the hours and pay of regularly employed individuals have thrown the burden onto temporary workers, who have become unemployed in large numbers. However, in recent reforms (Bentolila et al., 2011) Spain has learnt a few lessons from the successful experience of the Kurzarbeit scheme in Germany. Reductions in hours will now be incentivised by reducing firms' social security contributions while not reducing workers' entitlements to benefits.

3.3.4.2 Active labour market policies

Active labour market policies (ALMPs) have become more important over the last two decades in many European countries. Following years in which governments typically paid out unemployment and other benefits, but did little to influence the behaviour of recipients, allowing a variety of social problems to worsen and the costs of the benefits system to rise as the numbers of recipients grew, governments in the 1990s started to intervene. They applied more rigorous tests of availability for work, and attempted to make an active search for work by recipients a condition for receiving benefits. The separation between the public offices that paid benefits and those supporting job searches was ended. Long-term unemployed persons are now generally interviewed and given counselling and training to help them apply for and get work. Governments in some cases provide training or retraining programmes, and in some cases guarantee jobs for the long-term unemployed, if only for a fixed period. They may also subsidise firms to take on long-term unemployed workers, or subsidise other providers of training. In Britain such policies have been described as "harassment of the work-shy". The aim of ALMPs is to allow generous benefits to coexist with low overall structural unemployment and low long-term unemployment. ALMPs are an important ingredient in the bundle of policies that constitutes flexicurity.

While increased spending on ALMPs may improve the functioning of labour markets and reduce structural unemployment, it does not contribute to lower public deficits, and therefore is not currently an attractive policy for the cash-strapped economies of Europe's periphery. There may nevertheless be strong arguments for spending more on ALMPs and making them work better in many of these countries as fiscal conditions improve. The OECD figures in Table 3.3 show that Denmark spent 1.9 percent of GDP on ALMPs in 2010, followed by Belgium (1.5 percent), the Netherlands (1.2 percent), France (1.1 percent), and Ireland (1.0 percent). Portugal and Sweden spent around the OECD average at 0.7 percent of GDP, Spain slightly more along with Germany at 0.9 percent, while Italy comes low down at 0.5 percent, and the United Kingdom and the United States spent the least at 0.4 and 0.1 percent, respectively.

Table 3.3
Spending on active labour market policies as a percentage of GDP, 2010

Belgium	1.5
Denmark	1.9
France	1.1
Germany	0.9
Ireland	1.0
Italy	0.5
Netherlands	1.2
OECD average	0.7
Portugal	0.7
Spain	0.9
Sweden	0.7
United Kingdom[a]	0.4
United States	0.1

[a] 2009.

Source: OECD, *Employment and Labour Markets: Key Tables*, No. 9, http://www.oecd-ilibrary.org/employment/public-expenditure-on-active-labour-market-policies_20752342-table9.

Among the problem economies of the periphery, Spain has undertaken modest reforms recently (Bentolila et al., 2011), restricting the groups of workers eligible for subsidies on job creation and allowing private placement agencies to operate for the first time.

3.3.4.3 Employment protection legislation (EPL)

Excessively strong employment legislation has been a major problem in a number of countries. The OECD data in Table 3.4 include indices of the strength of the legislation for regular employees and temporary workers. The indices summarise factors like the size of the severance payments that firms are required to make, the periods of notice that are required before dismissals can be made, the range of conditions under which dismissals can be made, and so on. The distinction between regular and temporary workers has become very important in recent years since the introduction of temporary contracts in some countries has led to huge growth in the

Table 3.4

Employment protection legislation[a)]

	Regular workers		Temporary workers	
	1995	2007	1995	2007
Austria	2.9	2.4	1.5	1.5
Belgium	1.7	1.7	4.6	2.6
Czech Republic	3.3	3.1	0.5	0.9
Denmark	1.6	1.6	1.4	1.4
Finland	2.5	2.2	1.9	1.9
France	2.3	2.5	3.6	3.6
Germany	2.7	3.0	3.5	1.3
Ireland	1.6	1.6	0.3	0.6
Italy	1.8	1.8	5.4	1.9
Japan	1.9	1.9	1.8	1.0
Netherlands	3.1	2.9	2.4	1.2
Norway	2.3	2.3	3.1	3.1
Poland	2.1	2.1	0.8	1.8
Portugal	4.3	4.2	3.4	2.8
Slovakia	2.5	2.3	1.1	0.4
Spain	3.0	2.6	3.3	3.5
Sweden	2.9	2.9	2.1	1.6
United Kingdom	0.9	1.1	0.3	0.4
United States	0.2	0.2	0.3	0.3
OECD average	2.2	2.1	2.0	1.6

[a)] Score range 0–6, where 0 represents the weakest employment protection legislation.

Source: OECD Employment Outlook 2012, Table 2.A1.4, http://www.oecd.org/els/employmentpoliciesanddata/EMo%202012_Chapter%202-Annexes%202.A1%20and%202.A2.pdf.

numbers of workers on these contracts. The United States has very weak EPL; and the United Kingdom is not far behind.

Portugal has very strong EPL for regular workers and strong EPL for temporary workers, contributing to a very rigid labour market. Established workers are very secure in their jobs. External labour market pressure exerts only a weak influence on wage developments. Anecdotal evidence suggests that, in practice, employers pay substantially more than the legally required severance pay to avoid long, uncertain, and costly legal proceedings. Compared with the Netherlands, where legal issues surrounding dismissals of workers are typically resolved in a few weeks, cases in Portugal can take years.

Spain is in a similar position to Portugal's, with strong EPL for both regular and temporary workers. Nevertheless, firms can swiftly reduce their employment of temporary workers as their contracts expire. The introduction of temporary contracts has created a sharp divide between heavily protected workers in permanent jobs and a growing number of workers in temporary jobs. Spain has a long history of very high and volatile unemployment. Bentolila et al. (2011) describe the Spanish labour market as an extreme case of a dual labour market with a highly pronounced insider-outsider divide. Job losses since the financial crisis have mainly affected temporary workers, whose numbers have fallen by 30 percent, while the number of regular workers has barely decreased at all.

Under the pressure of public debt and employment problems, there have been recent labour market reforms in Spain, but they seem to have been relatively ineffective. Reforms undertaken in 2010 and 2011 were superficially wide ranging, affecting severance pay, hours of work, active labour market policies, and collective bargaining. The grounds for fair dismissal were broadened and made more explicit, and included a persistent loss in the firm's revenues. A new employment contract for permanent employees was introduced with less generous severance payments, severance payments for temporary workers were increased, and the number of successive temporary contracts a worker could be employed on was reduced (Bentolila et al., 2011). However, in September 2011 the maximum duration extension of all temporary contracts was extended to 4.5 years, until September 2013.

How likely are these changes to make a substantial difference? Bentolila et al. (2011) argue that since neither the government nor the social partners were interested in reform, the kind of reform undertaken did not significantly reduce the fundamental insider-outsider divide in the Spanish labour market. Reforms were watered down to make them acceptable to the unions and differential EPL was preserved. The position of collective bargaining was maintained. Some of the reforms actually benefitted insiders.

One of the most costly aspects of EPL in Spain, Portugal, Italy, and elsewhere, from the viewpoint of firms, and which greatly reduces firms' ability and willingness to adjust employment in the face of shocks to demand, is the use of the courts to adjudicate on the actual or proposed severances of workers. Court proceedings are generally very expensive, of very long and variable duration, and often result in large penalties applied to firms. In Italy firms have frequently been required to reinstate dismissed workers and repay their wages for the period of litigation. Recourse to the courts is not a bad thing per se. In the Netherlands the courts are used to adjudicate on proposed dismissals of workers, but proceedings typically take a few weeks, not years, and the outcomes are relatively predictable and proportionate. Problems really arise where the judicial system is unable to process cases rapidly. There is a good argument for taking employment disputes out of the courts and establishing a separate system of tribunals and arbitration that can resolve these issues speedily.

Denmark, as might be expected as the poster-boy for flexicurity, has very limited employment protection. Andersen (2011) notes that periods of notice for workers dismissed are short (a matter of weeks in most cases, up to six months at the most), and severance payments are low (up to three months' pay, and generally far less).

3.3.4.4 Minimum wages

Most countries have minimum wages. Table 3.5 lists them for 2011, measured as a fraction of median hourly earnings in the country in question. The table has no data for Germany, Italy, Denmark, Finland, Norway or Sweden, where minimum wages are set by collective bargaining on a sector by sector basis. The highest figure in the table is France at 60.1 percent, the lowest in Europe is Spain at 37.6 percent (leaving aside the two months of additional pay). The United Kingdom stands at 46.1 percent, the United States at 38.8 percent, and Japan at 37 percent.

Minimum wages raise the pay of the least well-paid workers, who are generally young unskilled individuals and may also be disproportionately women and part-time workers. The United Kingdom's minimum wage directly affects the pay of about 4.4 percent of workers. Minimum wages may reduce employment opportunities. However, the evidence is overwhelmingly that negative employment effects are small, if present at all. This is understood as being the result of monopoly power in labour markets on the employers' side, and efficiency wages. When employers have market power in labour markets, i.e., when they have some flexibility as to how much they pay their workers, they have an incentive to pay lower wages and recruit fewer workers. A well-chosen minimum wage rate can induce them both to pay higher wages and to offer more jobs. The efficiency wage argument is that when employers are forced to pay higher wages, they respond by giving their workers better training, using them more effectively, raising their productivity, or making greater efforts to retain them longer. These factors are at work when the labour market is not a textbook competitive perfectly-functioning market, but one where there is imperfect competition and information. Thus it appears that moderate minimum wages can have a beneficial effect on the distribution of earnings with no or very few offsetting detrimental effects, and there is a strong argument for countries having them.

However, there are discernible negative effects when the minimum wage for prime-age workers (25–64) is also applied to younger workers. In most countries the minimum wage for younger workers is a fraction of the prime-age rate. In the absence of a provision like this, young workers can be squeezed out of jobs. Sweden is an example where too little differentiation by age increases youth unemployment. In Greece a relatively high minimum wage with no allowance for young workers has raised youth unemployment in the past, but changes introduced in 2011 have begun to remedy this.

Table 3.5
Minimum wage rates as a percentage of median wage rate

Australia[a)]	51.8 (47.7)
Belgium	51.7
Canada	45.0
France	60.1
Greece	42.9
Ireland	52.9
Japan	37.0
Netherlands[b)]	43.6 (47.1)
New Zealand	59.1
Portugal[c)]	48.0 (56.0)
Spain[c)]	37.6 (43.8)
United Kingdom	46.1
United States	38.8

[a)] Two estimates, one from LFS, other from Enterprise Survey. – [b)] Figure in parentheses includes 8% holiday supplement. – [c)] Figure in parentheses includes 2 months extra salary.

Source: Report of UK Low Pay Commission, 2012, Table A3.2, data obtained from OECD min wage database and median earnings for full-time workers, mid 2012.

3.3.4.5 The tax wedge

The tax wedge summarises the effects of employers' and employees' social security contributions, income tax and other taxes on the percentage difference between the amount received by workers and the gross amount paid by firms. A high tax wedge reduces the equilibrium employment rate and the structural unemployment rate. The tax wedge in many European countries has been high, and is often cited as a cause of high structural unemployment. Table 3.6 gives summary data for a number of OECD countries. Over the twelve years before 2007, a number of countries took steps to reduce the size of the tax wedge. Most strikingly, Ireland reduced it from 26.8 in 1995 to 2.1 percent in 2007, having been able to cut tax rates in a booming economy with buoyant public finances. Both the United States and United Kingdom made large reductions: the United States from 24.4 to 11.5 percent, the United Kingdom from 26.1 to 13.8 percent. Italy achieved a substantial reduction from 44.9 to 32.8 percent, Germany a modest reduction from 37.3 to 32.4 percent, and Finland from 42.1 to 35.6 percent. However, in some European countries the tax wedge increased in size, from 34.9 to 60.8 percent in the Netherlands. In most others the size of the wedge remained broadly unchanged. Portugal, at 26.6 percent in 1997 and 23.6 percent in 2007, and Spain at 33.3 and 31.1 percent, do not stand out as being particularly high relative to many other European countries and are, indeed, close to the OECD average.

Table 3.6

Tax wedges

	1995	2007
Austria	27.2	27.4
Belgium	40.3	37.5
Denmark	30.9	30.4
Finland	42.1	35.6
France	39.5	40.2
Germany	37.3	32.4
Ireland	26.8	2.1
Italy	44.9	32.8
Japan	13.1	23.0
Netherlands	34.9	60.8
Norway	24.4	28.5
Portugal	26.6	23.6
Spain	33.3	31.1
Sweden	42.2	38.0
United Kingdom	26.1	13.8
United States	24.4	11.5
OECD average	30.8	28.8

Source: OECD Employment Outlook 2012, Table 2.A1.4, http://www.oecd.org/els/employment policiesanddata/EMo%202012_Chapter%202-Annexes%202.A1%20and%202.A2.pdf.

In the current recession it has been suggested that high unemployment economies might reduce taxes on employment (or social security contributions) and shift taxation to indirect taxation like value-added tax (VAT), which does not affect the size of the wedge. This "fiscal devaluation" also promotes exports, as the costs of producing exported goods are reduced by the reduction in taxes on labour and not affected by the increased VAT. For countries that need to regain competitiveness in the euro area, this may be an attractive strategy. Keen and de Mooij (2012) estimate that a shift of around 1 percent of GDP from labour taxes to VAT (achieved by a cut in labour taxes of around 2.7 percentage points and a roughly similar rise in the VAT rates) can increase net exports by between 0.9 and 4 percent of GDP; a useful boost. This policy has been proposed for Portugal and Greece, but was actually implemented in France in 2012.

3.3.4.6 Trade unions and collective bargaining

The influence of collective bargaining is generally thought to be in gradual decline, as old, highly unionised industries in manufacturing and other production industries decline, services become more prevalent, technology and the nature of work changes, the gender balance in the workforce shifts, and part-time work becomes more widespread. Nevertheless collective bargaining remains important in Europe. The OECD data in Table 3.7 show that there has been considerable stability in unions and bargaining arrangements. The coverage of collective bargains has remained largely unchanged. The most notable changes are the fall in Germany from 70 to 62.8 percent of the labour force, in Portugal from 87 to 65 percent, and in Ireland from 60 to 44 percent. The United States and United Kingdom stand out as having low coverage of collective bargains, as well as being the least corporatist countries, and having the least coordinated bargaining arrangements, being scored 1 (out of three) on corporatism and 1 (out of 5) on coordination, unchanged between 1997 and 2007. Some of the European countries have very corporatist and coordinated bargaining (Austria, Belgium, Germany, Ireland, Italy, the Netherlands and Norway).[2] Some countries are very corporatist,

[2] Very corporatist has been defined here as a country scoring a 3 on the corporatism index, and very coordinated as scoring a 4 or 5 on that index.

Table 3.7

Collective bargaining

	Corporatism[a)]		Coordination[b)]		Collective bargaining coverage[c)]	
	1995	2007	1995	2007	1995	2007
Austria	3	3	4	4	96.1	99.0
Belgium	3	3	5	4	96.0	96.0
Czech Republic	1	1	2	2	65.3	44.0
Denmark	3	3	3	3	84.0	80.0
Finland	3	3	3	3	86.2	90.0
France	2	2	2	2	91.0	90.0
Germany	3	3	4	4	70.0	62.8
Ireland	3	3	5	5	60.0	44.0
Italy	3	3	4	4	82.0	80.0
Japan	3	3	5	3	21.5	16.1
Netherlands	3	3	4	4	86.2	83.2
Norway	3	3	5	4	72.0	73.7
Poland	1	1	1	1	42.0	38.0
Portugal	2	2	3	3	87.0	65.0
Slovakia	1	1	4	4	51.0	40.0
Spain	2	2	3	4	87.6	85.3
Sweden	2	2	3	3	94.0	91.0
United Kingdom	1	1	1	1	36.0	34.6
United States	1	1	1	1	16.7	13.3
OECD average	2	2	3	3	68.3	61.8

[a)] Score range 1–3, where 1 represents countries with the lowest degree of corporatism. – [b)] Score range 1–5, where 1 represents countries with the least coordinated bargaining arrangements. – [c)] Measured in percent of the labour force.

Source: OECD Employment Outlook 2012, Table 2.A1.4, http://www.oecd.org/els/employmentpoliciesanddata/EMo%202012_Chapter%202-Annexes%202.A1%20and%202.A2.pdf.

but slightly less coordinated (Denmark and Finland), while another group is only moderately corporatist (France, Portugal, Spain and Sweden) and scores 2 on the corporatism index, and between 2 and 4 on the coordination index.

How do collective bargaining arrangements affect the workings of labour markets? There is an argument (Calmfors and Driffill, 1988) that highly decentralised labour markets with weak unions produce outcomes that do not differ greatly from a competitive labour market, and for that reason are relatively efficient. At the other end of the scale, highly corporatist economies, with highly coordinated unions may also produce good results because the unions, although powerful, are large enough ("encompassing") to take account of all the consequences of their actions. The problems arise in the intermediate situation, where corporatism and coordination are moderate and unions nonetheless have a lot of power. Here unions are able to protect their own workers, but are not large enough to take account of the wider economic and social consequences of their actions. This line of thought goes back to Mancur Olson (1982). In the intermediate case, high unemployment may emerge.

It is notable that Ireland, one of the troubled periphery countries, is among the most corporatist and coordinated; indeed it is the most corporatist and coordinated of those listed in the Table 3.7. It sits alongside Germany and the Netherlands, who are among the least troubled countries of the EU core. This may seem odd, but there are similarities. Germany and the Netherlands have both benefitted from wage restraint and greater competitiveness. Ireland has also benefitted through the 1990s and 2000s from a series of social pacts between unions, employers and government, which have also yielded wage restraint and high employment. Since 2008 after Ireland's debt problems began and unemployment shot up, cooperation between the social partners has allowed Ireland to adjust quickly, with deep cuts in public sector pay and employment, private sector pay cuts, and large tax increases. This cooperation has mitigated the rise in unemployment. Indeed, at the end of 2012 there were signs that unemployment has stabilised and is beginning to fall. This has been achieved with a remarkable degree of social harmony. It stands in marked contrast to the slow pace of adjustment and resistance to change in other troubled periphery countries.

Germany's cooperative industrial relations have been the envy of British commentators since the 1960s, when Germany's productivity and competitiveness in exports sustained strong current account surpluses and growth. While wage determination in Germany continued to be dominated for a long time by industry-wide bargains between relatively powerful unions and employer organizations, there has been growing flexibility since the early 1990s, when early plans to equalise wages between Western and Eastern parts of Germany had to be tempered to accommodate the economic problems of enterprises in the East. In 1993 a landmark settlement between the unions and Volkswagen introduced deep cuts in working time and pay in order to preserve employment. Competition from Eastern Europe after 1989, with the prospect of jobs being relocated to Poland and other states just to the East of Germany, contributed to a shift in the balance of power between social partners towards employers. The influence of unions in Germany has been in slow, but persistent decline. Whereas in 1996 union bargains covered 70 percent of the labour force in Western Germany, by 2009 they covered only 55 percent; while for the East these figures are 57 and 40 percent respectively. The Hartz reforms also contributed to the unions taking a less rigid approach. Wages scarcely grew between 2001 and 2008 (Burda and Hunt, 2011).

In contrast to Ireland and Germany, and indeed, to other more corporatist and coordinated economies, collective bargaining in Spain, Portugal and Greece has contributed to high and volatile unemployment and resistance to adjustment. Spain has had a system of automatic extension of wage bargains to all firms in the industry, of a particularly rigid form. Firms have not been free to pay wages below those stipulated in collective bargains, or to employ workers for fewer hours. This, combined with the strong protection of the employment of regular workers, has created large scale unemployment among temporary workers. Changes demanded by the troika of international lenders have brought about reforms in this area (Bentolila et al., 2011). Firms in distress are now allowed to opt out of the wage set by the industry collective bargain by reaching an agreement with their workers, but only for a period of up to 3 years. Reforms enacted in June 2011 give firm-level agreements precedence over industry-wide agreements, providing the latter do not stipulate otherwise.

Automatic extension of wage bargains has been the rule in both Portugal and Greece, with similar results.[3] It has sustained increasing (money) wage rates since 2008, despite growing unemployment. Combined with EPL for regular employees, it has placed the burden of job losses on temporary workers.

3.3.4.7 Flexicurity

In the eyes of the OECD and the European Union, flexicurity is a model of a successful bundling of labour market institutions, which they are keen to promulgate. Denmark and the Netherlands are currently its leading examples. "Flexicurity refers to a combination of loose employment protection legislation (EPL), generous unemployment benefits and strong efforts on active labour market policies (ALMPs)." (Koster et al, 2011).

Reform of labour markets has often proved a slow and controversial process because so many insiders stood to lose from reforms that would have weakened their grip on jobs and exposed them to greater competition from outsiders (Saint-Paul, 2000; Thompson, 2009). Flexicurity tries to buy off the potential losers from reduced employment protection with the promise of high aggregate employment, and therefore of good re-employment prospects if workers become unemployed, continued generous benefits and vigorous active labour market policies. This means training and education for the unemployed to improve their re-employment prospects, policies that tie generous benefits to their availability for and active search for work, and pro-active policies on the part of the authorities to present unemployed persons with suitable vacancies for which they must apply. Flexicurity aims to make jobs more contestable, increase labour turnover, and to allow firms to contract and expand more rapidly, which should enable the economy to respond more rapidly to shocks and changes in technology.

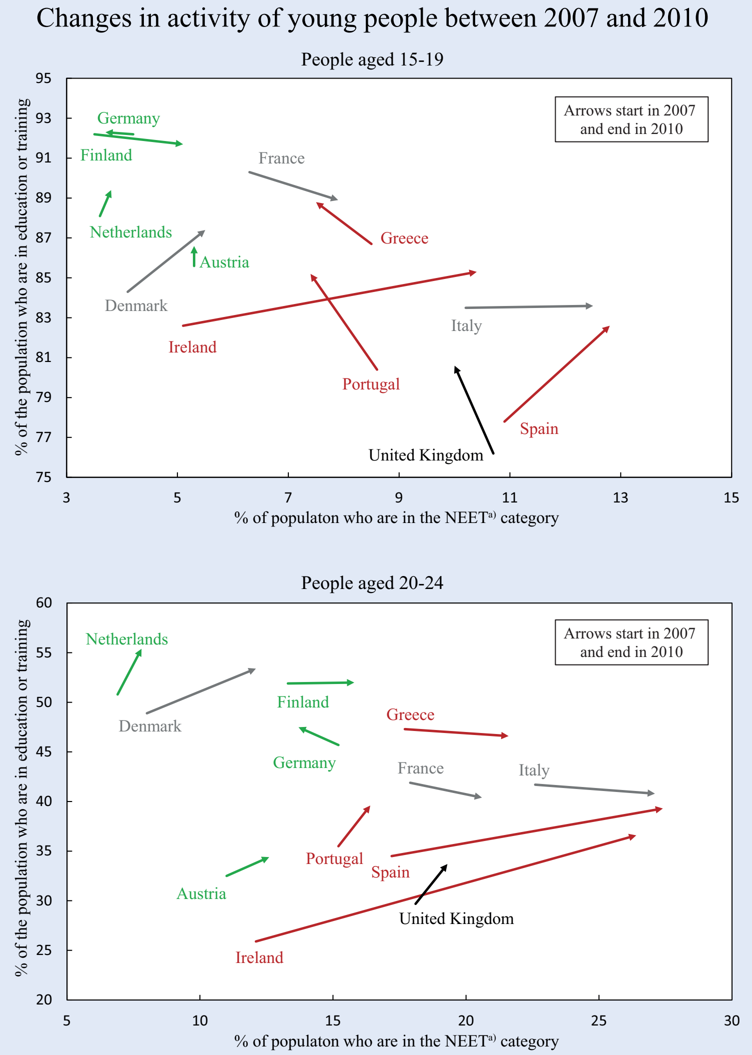
The Dutch have adopted a model similar to the Danish, but one that is more reliant on combinations of non-standard work, such as temporary agency work and part-time work, with regular social security rights (Koster et al., 2011).

It is interesting that while Denmark has achieved good labour market outcomes, it does not stand out in terms of summary measures of labour market institutions. However, as Andersen (2011) notes, Denmark spends by far the highest share of GDP on active labour market policies (1.9 percent). The unemployed in Denmark are required to accept places on education and training programmes and to follow up job vacancies if they wish to continue to receive benefits.

[3] Portugal's labour markets share some features of Spain's. They are described as highly inefficient, with poor institutions constraining wage and productivity developments. Private sector real wages only started to decline in 2011, supported by "widespread administrative extension of collective agreements, long-lasting unemployment benefits and pervasive labor market segmentation" (Pina and Abreu, 2012). Between 2007 and 2010 minimum wages increased by 5.3 percent per year on average and there was another 2.1 percent increase in 2011. Around 12 percent of all employees were on the minimum wage in 2010. Portugal has, like Spain, a sharp divide between permanent and temporary jobs, with permanent jobs enjoying very strong protection against dismissal, and temporary jobs very weak protection. Bentolila et al. (2010) regard the segmentation of labour markets into permanent and temporary jobs with differing amounts of employment protection as a particularly serious problem, and believe that ending this segmentation should be a policy priority.

The recent rise in unemployment in Denmark may cast doubt on the strength of the case for flexicurity. Unemployment had fallen to 3.4 percent in 2008, but has risen to 8.0 percent in 2012 Q2, while long-term unemployment has risen from 0.5 in 2008 to 2.2 percent in 2012 Q1. Youth unemployment rose from 5.3 percent of the 15-24 year-old population in 2007 to 9.8 percent in 2012 Q1 (see Figures 3.1–3.4). It is a feature of a labour market in which employment protection is weak that unemployment should rise sharply after a fall in demand for goods. However, labour turnover remains relatively high and there is a good flow out of unemployment into work, limiting the rise in long-term unemployment and youth unemployment (Andersen, 2011). It appears that some of the unemployment increase in Denmark resulted from the end of a boom in the construction industry at the time of the 2008 financial crisis, which then increased the impact of the recession.

Figure 3.7



[a] Not in employment, education, or training.
Source: OECD, Education at a Glance 2012, Table C5.4a.

The counterexample is the United Kingdom, where despite a steep fall in aggregate demand and GDP, and very weak EPL, unemployment has risen remarkably little since 2008. Of course, this has been helped by weak unions, relatively low unemployment benefits, and consequently flexible real wages.

3.4 Youth unemployment

3.4.1 Education, employment, training, and inactivity among young people

The data displayed in Section 3.2 indicate that young workers have been hit more than adults by the recent economic crisis (Bell and Blanchflower, 2011; Scarpetta et al., 2010), and that the crisis is more serious in some countries than in others. Of course, the alarming youth unemployment rates seen above are a large percentage of relatively small labour forces: as a fraction of the population in the same 15–24 age range, the unemployed in early 2012 were 15.5 percent in Greece, 20.0 percent in Spain, 11.0 percent in Ireland, 13.6 percent in Portugal and 10.4 percent in Italy. Since many youths are engaged in study or training schemes, and some of those that drop out of schooling may not bother to engage in the search activity that would classify them as unemployed, NEET (not in employment, education, or training) inactivity rates provide a better indication of youth labour market problems.[4]

Figure 3.7 displays data, available only until 2010 for the euro area countries discussed above. Since the onset of the crisis, youth activity rates have deteriorated sharply in problem countries, in marked contrast with the stable or improving situation of

[4] For example, in the United Kingdom approximately one million 15–24 year-olds were unemployed in 2011, but over 1.4 million were NEET, and both categories included some 400,000 more individuals than at the 2001 cyclical low point (ACEVO, 2012).

Germany and its neighbours. To set the stage for our analysis of how such differences may depend on institutions and policies, we focus in this section on the remarkable divergence within Europe between Germany and a number of nearby countries on the one hand, and the "problem" economies on the other, as regards these youth inactivity rates.

Institutional features of the labour market play more or less obvious roles in shaping youth employment prospects. Legal or contractual minimum wages can be set too high for the employment of young unskilled workers to be profitable, contractual wage scales may not allow suitable pay differences between young and more experienced workers, and stringent employment protection disproportionately increases the unemployment rate of young workers (who will be seeking their first job no matter how low the job finding rate is) relative to that of older workers (who face similarly difficult job-finding prospects, but are not as likely to become unemployed when firing them is difficult). For given labour market institutions, of course, the overall cyclical conditions of the labour market (Bell and Blanchflower, 2009) and the relative size of young labour market entrant cohorts (Shimer, 2001) play the larger role in determining both the overall and the youth unemployment rates. Aside from demographic dynamics, youth unemployment tends to be broadly proportional to total unemployment along the cycle, as well as across countries. Along the latter dimension, institutional features do appear to significantly affect the level and cyclical sensitivity of youth unemployment, which are relatively higher in more rigid labour markets: labour market rigidity reduces both unemployment inflows and outflows for mature workers, with ambiguous implications for their unemployment rates, but tends to leave young workers unemployed in greater numbers, especially when hiring rates are further reduced by recessions.

When unemployment is the result of ongoing search processes meant to match workers to suitable jobs under imperfect information, there are good reasons for youth unemployment to be higher than that of older age groups. For youths, search has a larger potential payoff and, inasmuch as they can rely on family support rather than having to provide it, search is less costly than in the case of older workers. The involuntary unemployment that results from wage and employment rigidities, conversely, can damage the young workers on which it is concentrated more seriously and permanently than older workers, because any loss of employability has more important implications for human capital when it occurs earlier in life, and reduces earning over a longer remaining career. To the extent that the latter mechanism is at work, therefore, there is reason to worry about the large and increasing inactivity rates of youths in the European countries that were hit hardest in the crisis, especially insofar as they reflect insufficient institutional support for young people.[5]

The search-and-learn process underlying the relatively high unemployment and frequent job transitions of youth in the lightly regulated labour markets of Anglo-Saxon countries may or may not be the most effective way of matching people to the work that they can do comparatively well, which is an essential ingredient of any economic system's productivity. Society can support youth in that endeavour, and both labour market institutions and educational systems differ across countries in relevant ways.

3.4.2 Education, vocational training and apprenticeships

Germany, Switzerland, Austria, and Denmark have maintained a highly successful dual education and training system through apprenticeships. In all four countries, over 40 percent of young people who leave school when it ceases to be compulsory take up apprenticeships. These require around three years training on the job with at least one day a week at a vocational college (the Berufsschule), and lead to a formal qualification which yields a "right to practice", legally required to work in many occupations. Employers can only offer young people jobs in a recognised occupation under an approved training contract. The Federal government, employers' organizations, local chambers of commerce, and trade unions are all involved in and support the system. The German system imparts not only job skills, but many social skills, too. "Respect for authority, punctuality, teamwork, and learning how to learn were all fundamental to the employer's decision as to whether the apprentice was suitable to be taken on for a given job." In Germany, "The social partners – employers, trade unions and politicians – combine their resources to enable the transition from school student to apprentice. They are also responsible for approving the off-site VET curriculum, agreed

[5] Ha et al. (2010) suggest that higher youth unemployment may, in fact, reflect age-biased changes in the structure of the welfare system: in the United Kingdom, for example, youth unemployment had already begun to increase in 2004, possibly as a result of the fact that in the early 2000s the UK Employment Service shifted its focus away from young people on Jobseeker's Allowance, and towards Lone Parents and Incapacity Benefits recipients.

nationally and managed by the local chambers of commerce, who also certify the skills achieved." (Steedman, 2001).

Britain is one of many countries where vocational educational training (VET) is inadequate and disorganised. The apprenticeship system does not work as intended and Colleges of Further Education, which provide vocational education, are the Cinderella of the educational world. British apprenticeships before the 1980s were five-year long "timeserving" preparations for young male workers' entry into skilled manual jobs, governed by custom and practice, and informal agreements between employers and unions. They catered typically for only around 120,000 young people per year, 80 percent of them male, and in the late 1980s numbers fell to 58,000. Since then there have been repeated reorganizations with only modest success. After being initially absorbed into the Youth Training Scheme, which kept them alive despite its variable quality, in 1986 they came under the framework of the National Vocational Qualifications (NVQs), and then the Modern Apprenticeship scheme. While less successful than intended, the latter had 279,700 apprenticeship starts in 2009/10. A persistent problem is that employers have been marginalised in the design and operation of the scheme, and the providers of training have incentives to make schemes as short as possible. British employers have remained suspicious of formal youth training schemes and NVQ certificates, and prefer general educational qualifications of a more academic kind like GCSEs and A levels. British employers appear not to think that VET contributes to productivity; they use educational achievements to sift potential employees, and once employed, train them on the job.

Hilary Steedman remains of the view that a good apprenticeship scheme is important: "School- and college-leavers in Britain desperately need the skills and smooth transition to working life that apprenticeships provide. The economy desperately needs a more highly-skilled workforce. More apprenticeships providing skills comparable to those in competitor countries can help achieve this." However, despite the United Kingdom's ramshackle provision of apprenticeships and VET, youth unemployment, acquisition of skills on the job, and the rate of return to the training that does occur are less disappointing than may be feared.

Ireland is in a similar position to the United Kingdom from this perspective. Ireland had a traditional time-serving apprenticeship system until 1991, when it was replaced by a standards-based system.

Two countries with rather different systems are Sweden and France. France provides full-time vocational education in schools and colleges, rather than on-the-job, and had 434,000 apprentices in 2008. In the post-war period apprenticeship suffered from political indifference, and sometimes hostility. Recently there has been a revival, partly to fight youth unemployment among the least qualified. France, like the United Kingdom, looks to the German system as a model. Sweden also has a school-based education route for 16 to 19 year olds, and has never had an apprenticeship system. However, the Swedish model has clear failings. This system does not make students "job ready" and leads to high youth unemployment. Moreover, school-based qualifications are not widely recognised in industry. In building, for example, workers need to do an additional apprenticeship by working in a firm to obtain a qualification that employers recognise. Thus Sweden introduced an apprenticeships system in 2011, although it does not seem to be radically different enough from the existing model. "Leavers from VET school, in particular early leavers, have difficulty in finding a first job. Earnings differentials are compressed and heavily regulated by collective bargaining and wage structures do not normally allow for young people to be paid a training wage/lower wage on entering first employment. Employment protection is also very strong, meaning that employing a young person entails relatively high costs and risks." (Steedman, 2010). Both Sweden and France appear to be moving towards the Germanic system as a response to the perceived inadequacies of their existing provision.

These are a few examples, but vocational training and apprenticeships in other European countries seem to have similar problems. Portugal, Spain, Italy, and Greece all have limited provision for training the less academically able half of the age cohort and smoothing the transition from school to employment.

Should the schooling system just equip youths to engage in the labour market matching processes, or should it steer them through the process of detecting and acquiring skills suitable to specific jobs? As the discussion above shows, different countries answer this question in different ways. In Germany and its neighbours (and in Japan), young people are assigned to different tracks early in their school career. In these countries vocational education prepares youths for specific jobs and introduces them to the labour market through administered apprenticeship contracts. In Anglo Saxon countries, on the other hand, schooling tends to be comprehensive, education is non-specialised until late in the school career, and flexible wage and employment relationships allow for the worker-financed accumulation of general on-the-job learning, as well as for individual search-and-matching processes of job allocation in competitive market settings.

Other countries display a mix of the two systems. In some, the mix lies in-between the two extremes, with some tracking, as well as some opportunities for in-work training and sorting. In others, however, features of the two systems are less appropriately mixed, as is the case when ill-focused and uninformative schooling is followed by would-be rigid work careers. This can easily result in unemployment, and in the poor matching of workers to jobs and of wage aspirations to productivity. To fill the gap between school qualifications and relatively rigid labour market relations, "non-standard" and temporary contracts can be and have been introduced that allow a degree of on-the-job evaluation and learning. These are unsurprisingly much more prevalent among young people than among prime-age workers (in France, about 50 percent of employed workers aged 15–24 are in temporary contracts, but only 10 percent of 25–54 year old workers), and this figure varies considerably across countries (ranging from 6.5 percent in Ireland to 66.3 percent in Spain).

In general, the choice between allocating youth to vocational and academic tracks, or offering comprehensive education to all, depends on the extent to which society believes individual talents are observable early, and should be allowed to influence life outcomes even when they reflect the luck of being born to well-educated parents.

The extent to which education and job search should be publicly funded and organised depends on market failures, especially the failure to provide accurate information and adequate access to financial markets. Various approaches may be efficient, depending on underlying characteristics, and no clear pattern emerges from the data: the OECD's Education at a Glance finds no clear correlation between higher VET participation levels and lower unemployment rates among 15-29 year-olds, and only somewhat weak evidence that participation in VET programmes is associated with lowering youth inactivity levels.

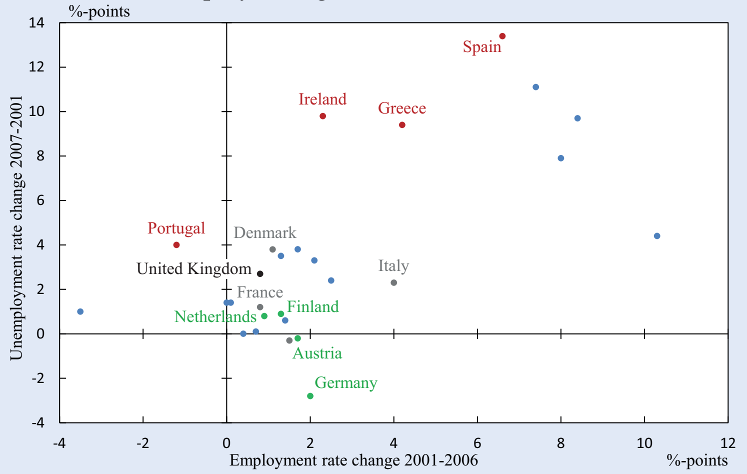
It is clear that the pros and cons of early specialisation depend on labour market characteristics that differ over time, as well as across countries. The data in Figure 3.7 show both cross-country differences in the situation of young people, which are to be interpreted in the light of educational system characteristics and development levels. Germany and its neighbours already had low rates of youth inactivity prior to the crisis, even at a time when their overall unemployment rate was relatively high; and changes during the crisis period, reflecting the severity of cyclical developments and choices to remain in education. In crisis-hit countries, youths stay in school longer: this is explained by the lack of employment options, which were previously so plentiful as to give them incentives to go into work at very early ages in countries like Ireland; but more youths also fall into the not employed, not in education or training (NEET) category, which is, of course, very worrisome, as persistent loss of employability threatens an economy's prospects of recovery. In countries like Spain, France, and Italy non-standard employment has been an alternative to both searching for a job while unemployed and apprenticeships. When schools are not equipped to provide the labour market with suitable information, temporary contracts may provide learning opportunities, much like apprenticeships. However, they may also confine workers to the lower segment of a dual labour market and, as the figure shows, leave them exposed to the brunt of labour demand shocks.

3.5 Labour market institutions and sensitivity to shocks

Differences in policies and institutions can give rise to large cross-country differences in the overall impact of economic downturns on unemployment, labour income and earnings inequality. The OECD Employment Outlook 2012 uses evidence from firm-level data to assess these effects in the context of the effects of the recent downturn, and finds that strict employment protection provisions for workers on permanent contracts reduce the importance of employment adjustment relative to working time and wages, while more temporary work is associated with more employment adjustment relative to working time and wages. Coordinated wage-bargaining institutions can contribute to good structural performance and labour market resilience. Coordination is

Figure 3.8

Unemployment growth after the crisis and employment growth before the crisis



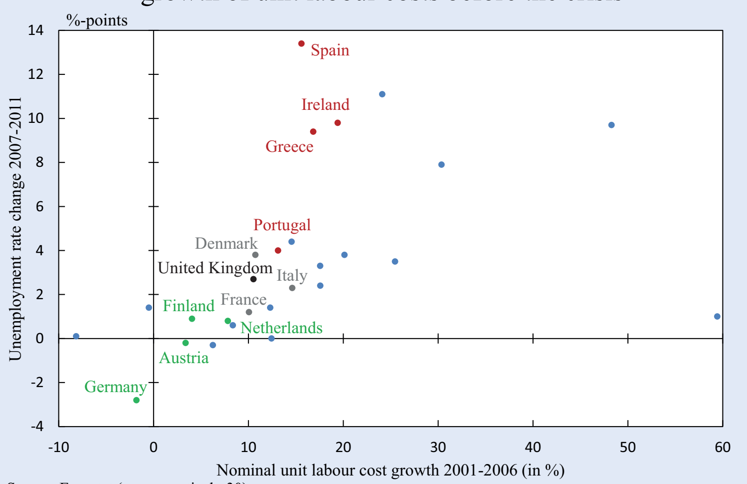
Source: Eurostat (une_rt_a, lfsi_act_a).

important for achieving low structural unemployment rates, and mitigating the effects of shocks by facilitating adjustments to wages or working time. Institutional settings that favour the use of temporary employment contracts, such as stringent employment protection for regular workers are associated with both weaker structural outcomes and less labour market resilience.

Perhaps unsurprisingly, the OECD concludes that policies and institutions that are conducive to good structural labour market outcomes also tend to be good for labour market resilience, where "good" structural outcomes are low unemployment rates (rather than, for example, low income inequality), and the policies and institutions conducive to them are those advocated by the OECD's revised Job Study strategy. However, that tendency is not as strong as one might hope.

Figure 3.9

Growth of unemployment after the crisis and growth of unit labour costs before the crisis



Source: Eurostat (une_rt_a, tipslm30).

The large dispersion of unemployment rates across countries in the aftermath of the crisis shock reflects not only differences in institutional structures, but also the different intensities of that shock. In practice, the countries with the highest unemployment increases and final levels in Figures 3.1 and 3.2 are also those experiencing the worst banking and sovereign debt problems. Employment tended to be more fragile, and unemployment more concentrated in youth and other secondary segments of the labour market, in the same countries that turned out to be ill-prepared to withstand negative financial shocks. To a large extent, unemployment developments in fact mirror the different severity of the crisis in the various countries.

It turns out that the countries that have suffered the largest post-crisis increases in unemployment were those that had enjoyed the largest pre-crisis increases in employment (Figure 3.8). Some countries appear to have been much more volatile than others. Labour markets like that of Spain, which had enjoyed the largest deregulation-driven employment gains, unsurprisingly suffered a major breakdown. Just as exceptional financial returns were brought about by inconsiderate and unregulated leverage, it is legitimate to wonder whether the strong employment performances of recent years were just an illusion conjured up by labour market deregulation. Denmark fits this pattern, to some extent, while Germany and its neighbours stand apart from it.

Figure 3.9 shows a positive relationship between the increase in unemployment after the crisis and the growth of unit labour costs before it (which did not prevent employment growth because GDP growth was also relatively strong).

3.5.1 Germany

Thus the outstanding performance of the German economy, which has staged a remarkable turnaround since the 1980s (Möller, 2012) when the country was the embodiment of eurosclerosis (Giersch, 1985), is partly explained by the character of the macroeconomic shocks that originated in the global economy and had asymmetric implications within Europe.

While flexibility and financial development became liabilities for other economies, the manufacturing-intensive export-oriented German economic system proved able to withstand this particular crisis well. It is possible that Germany performed strongly in the crisis, and poorly before it, not due to its reforms, but because of the financial and services character of the crisis, in the context of which (unreformed) temporary layoff programs and a strong manufacturing export orientation made it possible for the country to limit employment losses and to recover quickly as emerging countries restarted importing. Nevertheless, German unemployment has continued to fall since 2008, partly due to the successful restraint of money wage growth by employers and unions, and partly due to the successful system of apprenticeships and VET. As well as the overall low unemployment rate, youth unemployment has also remained low.

3.5.2 Italy

Passive short-work and temporary layoff measures (Kurzarbeit and Cassa integrazione guadagni in deroga) have subsidised permanent employment relationships not only in Germany, but also in Italy. Firm-side financial problems have more inefficient implications if they lead to permanent severance of "solvent", but illiquid employment relationships. In other countries, the crisis triggered massive expenditure on income and job-search support to permanently displaced workers. To understand which of these policy responses was the most appropriate, one needs to assess whether the shock was just a manifestation of financial difficulties and temporary aggregate demand shortages, or instead called for permanent restructuring and reallocation in specific countries. Italy's technocratic government has outlined a sweeping set of reforms. These reforms aim at reducing labour market duality, introducing flexibility in regular contracts at the same time as non-standard contracts are phased out, and funds previously used to finance German-style on-the-job temporary layoffs are channelled towards universal unemployment insurance.[6] Much as flexibility could improve labour market efficiency in a less troubled situation, limiting temporary employment opportunities and making it easier to dismiss workers for economic reasons is likely to be destabilising in a crisis situation, where the only jobs that might be created would be temporary, and fear of dismissals may encourage employed workers to perhaps work harder, but certainly to spend less.

3.5.3 Spain and Portugal

Other countries have sought a way out of high unemployment by allowing employers to offer temporary contracts to new workers, while retaining strong protection for existing permanent jobs. As the experiences of Spain and Portugal show, this strategy has proved less successful. It has created a bifurcated labour market, with marked differences between insiders and outsiders. In countries where the institutional school-to-work process is not sufficiently developed, temporary employment may substitute apprenticeships as a chance for young workers to learn "on-the-job" and for employers to train a young labour force. However, in countries that introduced labour market flexibility on the margins, deregulating temporary employment without changing employment protection legislation for standard regular workers, the employment impact of the crisis was strong and biased against young workers.

3.5.4 Greece

In contrast to the German experience of a fortunate constellation of economic shocks favourable to its industrial structure and labour market institutions, Greece has suffered a large fall in demand, which has instead exposed the weaknesses of its industrial structure and institutions. Labour force participation is low, and employment (as a fraction of the population) is low; while unemployment, noticeably

[6] Italy introduced a degree of flexibility at the margins of the labour market with its introduction of non-standard contracts in 1997, followed up by a 2000 law relaxing regulation of part-time employment, and by 2001 deregulation of fixed-term contracts. These changes made it possible to create "atypical" dependent jobs alongside the formally self-employed *Collaborazione coordinata e continuativa* employment relationships. Wage moderation prevailed in Italy between the early 1990s and euro area accession. During this period the pre-set planned inflation rate was ex post lower than actual inflation throughout Italy's disinflation, so that real wages did not keep up with productivity (and employment grew, along the labour demand curve).

long-term, youth, and structural unemployment, is high.[7] While public spending falls and taxes rise, other austerity measures and the global recession account for much of the problem, a substantial part of it is structural. Productivity in Greece has caught up with the euro area average since 1995, but nominal wages have grown faster, and unit labour costs have risen.[8] This has contributed to the decline in private sector employment in tradable goods and the rise in public sector employment. Wage bargaining arrangements, employment protection measures, the benefits system, pensions, access to professions, and education and training have all contributed to these trends.

Greece's neo-corporatist system of extended collective agreements, in operation since the 1930s, provides the main floor under wages (Anagnostopoulos and Siebert, 2012). The two main union federations are still funded by the state. An annual National General Collective Agreement (NGCA), supplemented by various sectorial agreements, sets a national minimum wage for private sector employees.

While union membership is low (24 percent of employees in 2008), coverage of bargains is high, bargaining at the industry and sector level predominates, and there has been a system of extension of bargains to all firms in the sector. Local or firm-level variations were (until 2010) only allowed to raise wages above the industry-wide bargain. Moreover, firm-level agreements were only allowed for the small fraction of firms with over 50 employees, and were actually used by only a fifth of the latter. A system of arbitration to which trade unions have privileged access has strengthened their position.[9]

In so far as change has occurred, it has done so under pressure from the European Union and the troika of international lenders. Changes in laws made in December 2010 have enabled greater flexibility. Firms and their workers are allowed to agree to lower wages than stipulated by the sectorial agreements, although the wages agreed in a national labour collective agreement still set a floor. The procedures for mediation and arbitration have been rebalanced to give both employers and workers a voice.

Until 2010, a relatively high minimum wage discouraged the employment of young workers (below 25). Changes in legislation in 2010 effectively allowed a lower wage for them (84 percent of the basic wage agreed at the national level), and one-year apprenticeships for youths aged between 15 and 18 years with wages at 70 percent of the minimum wage were introduced. More changes made in 2011 have allowed anyone between 18 and 25 to be employed on fixed-term contracts for up to 24 months at a wage that is 20 percent below the applicable collective agreement, whether national or sectorial. The OECD regards this as a step in the right direction, i.e. towards cutting youth unemployment, whose effects on hardship can be partly cushioned by Greece's extended family networks. However, they argue that it needs to be linked to the provision of more training to improve skills.

At the same time, employment protection legislation was relaxed in 2010. Firms now need to give only six months' notice of dismissal for white collar workers with 28 or more years of service, as opposed to 24 months previously, and can pay in instalments. Collective dismissals are defined less restrictively; probationary periods are allowed to be longer, and workers can be employed on temporary contracts for longer (36 months as opposed to 24).

3.5.5 The United Kingdom

The United Kingdom was hit by a large fall in aggregate demand in 2008. GDP fell substantially, and was still several percentage points below its peak even at the end of 2012. Unemployment has risen very little, from around 5.5 in 2008 to 8 percent at the end of 2012. Employment actually rose during this period. Commentators have puzzled at the implied fall in productivity. There are several factors at work here. One is the depreciation of the pound against the euro in 2008 and 2009, which created inflation and has allowed real wages to fall, while nominal wages continued to rise very slowly. Weak unions were unable to negotiate significant wage increases. Increasingly

[7] Overall employment was roughly 60 percent of the 15–64 age group in 2008, versus around 65 percent for the OECD and the euro area. For young workers aged 15–24 it was roughly 20 percent, compared with roughly 40 percent in the euro area, for women it was around 60 percent and for older workers aged 55–64 it was around 40 percent. The OECD put structural unemployment, measured by its estimate of the NAIRU, at 10 percent in 2010. Actual unemployment was over 12 percent of the labour force in 2010 (*OECD Economic Surveys: Greece 2011*) and had reached approximately 25 percent by the end of 2012.

[8] Unit labour costs grew at around 7 percent per annum between 1995 and 1999, versus around 1 percent in the euro area on average; and grew at 4 percent, versus 2 percent in the euro area from 2000 to 2008. They subsequently fell to 1.5 percent per annum in 2009–10, compared with 0.5 percent in the euro area. However, this leaves a substantial fall in competitiveness over the whole period from 1995.

[9] "Frequent recourse to arbitration, despite low union density, implies that a small number of insiders can influence wages for much larger groups, making negotiations less responsive to market needs." (*OECD Economic Surveys: Greece* 2011, p. 115).

meagre unemployment and other social security benefits encouraged pay deals that allowed reductions in working hours to preserve jobs.

The Jobseeker's Allowance (JSA), which was introduced in October 1996 as a reform of the UK system of unemployment compensation, increased the rate at which claimants left unemployment, but not because they found jobs; and the JSA did not do much to improve their long-term career prospects either (e.g. Petrongolo, 2009). Since 1996, the UK government has further reduced welfare support to the unemployed (with the notable exception of the various New Deals introduced by the New Labour Government). The interplay between reformed labour market institutions and the severity of the crisis may explain why there have been signs of conflict and social unrest in the United Kingdom and several other European countries, with some similarity to social and economic developments in European countries between the wars.

While the United Kingdom adopted a laissez-faire approach in its employment reactions to the crisis, notably refraining from raising modest unemployment benefits (indeed, they have been further cut back), Sweden has adopted a proactive approach aimed at restoring full employment through incentives for employers and the reduction of payroll taxes for those who hire, while trying to cushion the social effects of unemployment by relaxing the qualifying period for unemployment insurance.

3.6 Conclusions

3.6.1 General considerations

Over the course of time several different countries have jostled for pole position in the "good labour market" stakes (Bertola et al., 2002, discuss reversals of fortunes from the 1970s to the 1990s). Denmark's institutions and reforms looked very good before the current crisis, but its unemployment rate increased by a disturbingly large amount during the crisis. The Hartz reforms introduced in Germany's labour market created a lightly regulated, low-wage segment very similar to that enabled by Spain's and Italy's earlier reforms. This suggests that success might be partly due to good luck, as well as to good policies. Reforms should not be undertaken lightly and should not simply imitate past successes, which are no guarantee of future successes. They need to proceed cautiously, taking account of local circumstances.

Structural labour market problems must be addressed by reforms that reconcile the security, efficiency, and fiscal aspects of labour market policies. To be fruitful, reforms need to understand what policies and institutions do in different contexts.

The crisis calls for two types of policy reactions. Firstly, it requires policies that foster structural adjustments to persistent and potentially permanent shocks, such as those that call for shrinkage of finance, retail distribution, and construction in countries that need to develop a manufacturing export base. Lower wages are needed in some countries and are easier to achieve than higher labour productivity.

Secondly, policy reactions should focus on the impact of aggregate demand shortages and private and public financial confidence problems. Immediately prior to the crisis, increasing oil prices and a weakening euro were reasons to worry about second-round inflationary pressures from collective wage bargaining, and it was comforting to find evidence that deregulation, deunionization, and international and product market competition helped increase employment flexibility and keep wage reactions in check, as suggested by the empirical results of Bertola et al. (2012). In other words, labour market flexibility can be destabilizing in a crisis, and not positive. As with fiscal policy, medicines that are beneficial from a longer-run perspective can be detrimental if hastily administered in the midst of a low-confidence, high-uncertainty situation. Care has to be taken as regards the impact and short-run effects of labour market reforms; and it is important that these reforms should be credibly durable. Active labour market policies and unemployment benefit reductions are much more attractive and politically acceptable at times of plentiful tax revenues and expanding labour demand than during a recession. From every viewpoint country-level coordination and political cohesion proved much more important during the crisis than in the years prior to it, when shocks were mostly at the regional or sector level.

Tripartite wage agreements and public sector wage cuts could make important contributions to success in the face of country-specific issues in problem countries, as they did for many of those same countries on the path to EMU. However, the crisis has created severe politico-economic tensions both within crisis-hit countries and at the European level. Policy coordination at the European Union level would obviously be desirable, because while labour mobility across jobs and occupations is beneficial, cross-country labour mobility may contribute to crisis dynamics: if Greek workers migrate to Germany, they may relieve the Greek social security system of the need to pay their unemployment benefits, but certainly deprive it (and Greek pensioners) of their contributions. Unfortunately, European coordination of labour market policies is even more obviously politically difficult in the current situation. While small Baltic countries may be able to reform and implement massive internal devaluations, within larger countries reform efforts may worsen already critical political situations, because labour market policies are politically divisive and economically difficult. Throughout history, income distribution and risk sharing issues have always been addressed by collective schemes with a mix of administration, authority, and social pressure. Such schemes always were, and still are, at work for individuals in families, and for families in local communities. They were implemented at the national level in the context of the commercial and industrial revolutions that made Europe rich. Currently, the political cohesion needed to support them is weak within nations, not only in crisis-stricken countries such as Spain (where Catalonia would like to be freed of its obligations), but also in the United Kingdom (where cutting social benefits is widening the divide between rich and poor, causing urban minorities to feel oppressed, and strengthening the cause of Scottish separatism), and even in Germany as the political appeal of supporting Eastern federal states fades. It is even weaker at the European level, where it would be most useful if, as is likely, harmonised labour market regulation needs to accompany market integration.

3.6.2 Some specific suggestions

Notwithstanding the cautionary notes and general principles set out above, some aspects of policy in some countries stand out as strong candidates for (further) attention:

- The two tier labour markets that have emerged in Spain, Portugal, Greece, and to some degree Italy, have thrown the burden of job cuts onto a particular segment of the labour market, those individuals on temporary contracts. Meanwhile, the heavily protected workers in regular jobs feel little pressure from the existence of many unemployed persons to moderate wage claims or change working practices to increase productivity. Changes are taking place, but more needs to be done to reduce, if not eliminate, the distinction. The amount of job protection enjoyed by workers should depend on their length of service in the job, and should be set at a level that balances the interests of current and future workers and employers.
- When severance cases are tested in the courts, with long delays and great uncertainty as to the outcome, the administration of EPL is highly inefficient. There is a good case for removing employment disputes from the courts and instituting tribunals and arbitration procedures to deal with them more quickly, cheaply, and with greater certainty.
- The automatic and legally enforced extension of wage bargains to all firms in an industry or sector in a number of countries has contributed to wages not responding to labour market conditions, inflexibility and high unemployment. It can give a small group of workers excessive influence over pay and employment in an industry. Legal provisions that support this practice need to be carefully reconsidered.
- Many European countries need to develop better arrangements for vocational education and training. Apart from Germany, Austria, and Switzerland, provision for roughly half of the age cohort that does not go to universities has been neglected, contributing to higher than necessary youth unemployment.

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