

# Economic Policy #11

## Labour Market Policy

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- Labor market: definitions and indicators
- Efficiency of labor market
- Policies
  - active labor market policies
  - regulations of labor market
  - labor taxation
  - social policy incentives

# Definitions

Total population P

Working age population (15-64): T

Labour Force A

Inactive I

Employment: E

Unemployed  
U

less than a year

more than a year

Self-employed

Employees

full time job (permanent or temporary)

part-time job (permanent or temporary)

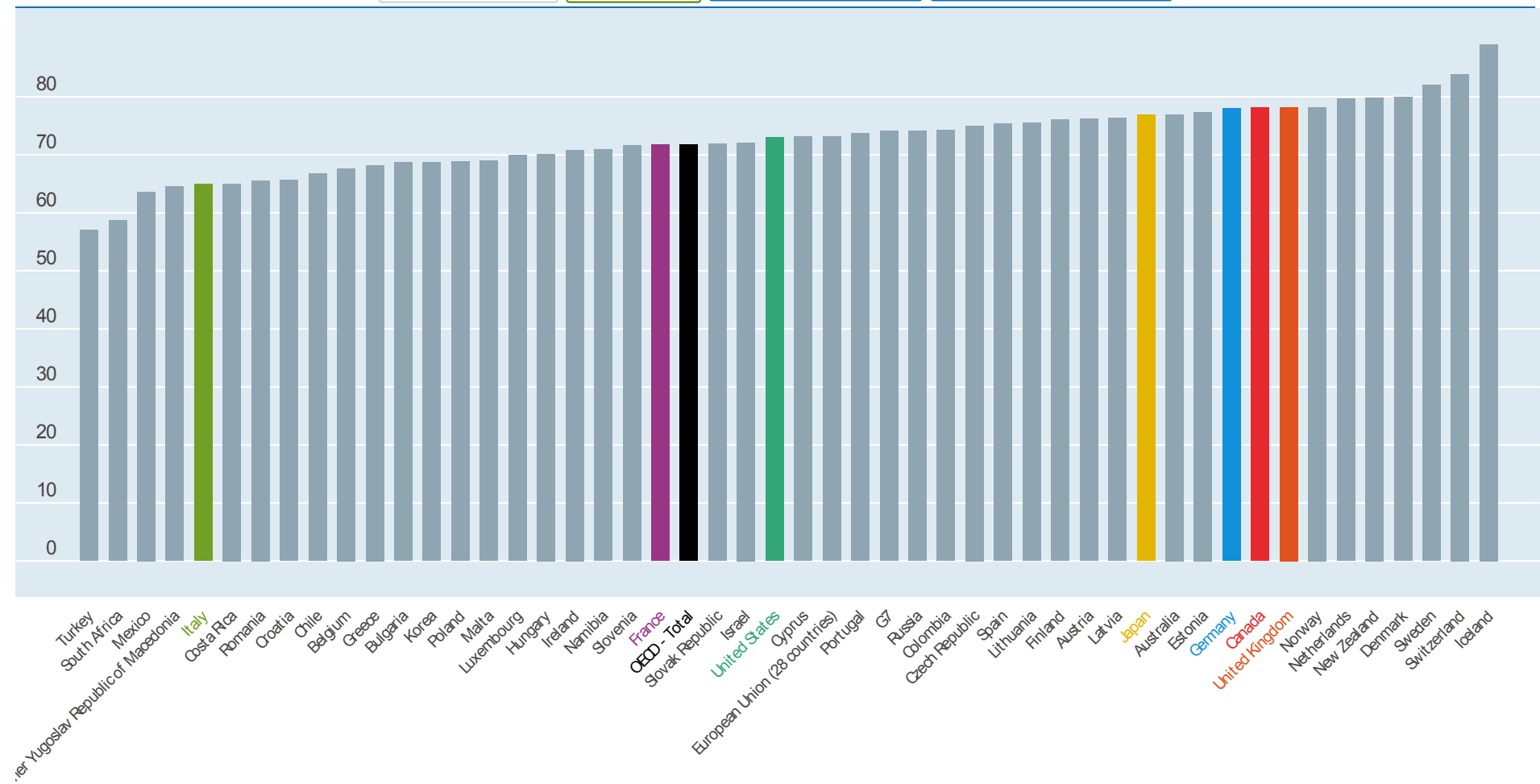
# Basic indicators

- **Participation rate:**  $A/T$
- **Employment rate:**  $E/T$
- **Unemployment rate:**  $U/A$

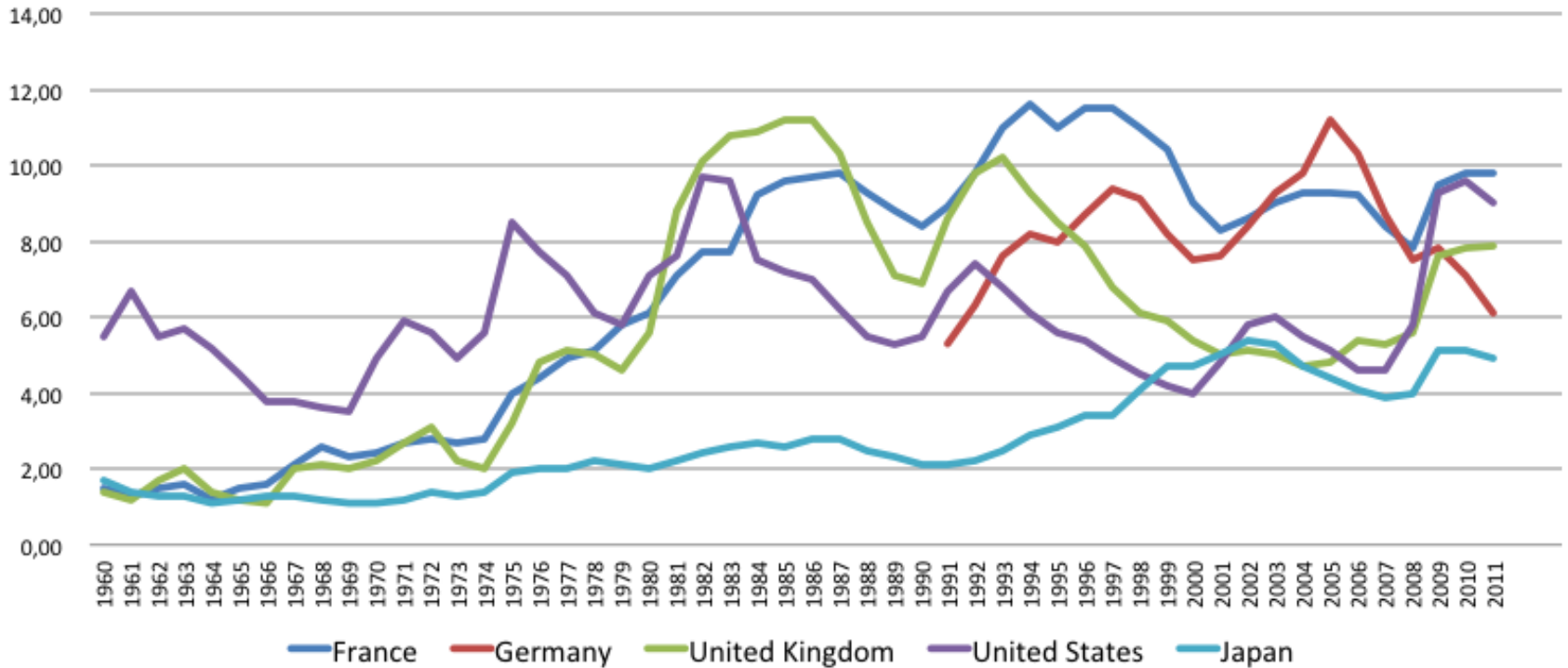
## EU-27 (2016)

- $P = 510,3$  mil.
- $T = 333,2$  mil. (15<age<64)
- $A = 240,8$  mil.  $A/T = 72,2 \%$
- $E = 219,9$  mil.  $E/T = 66,0 \%$
- $U = 20,9$  mil.  $U/A = 8,7 \%$

# Participation rate (OECD, 2017)



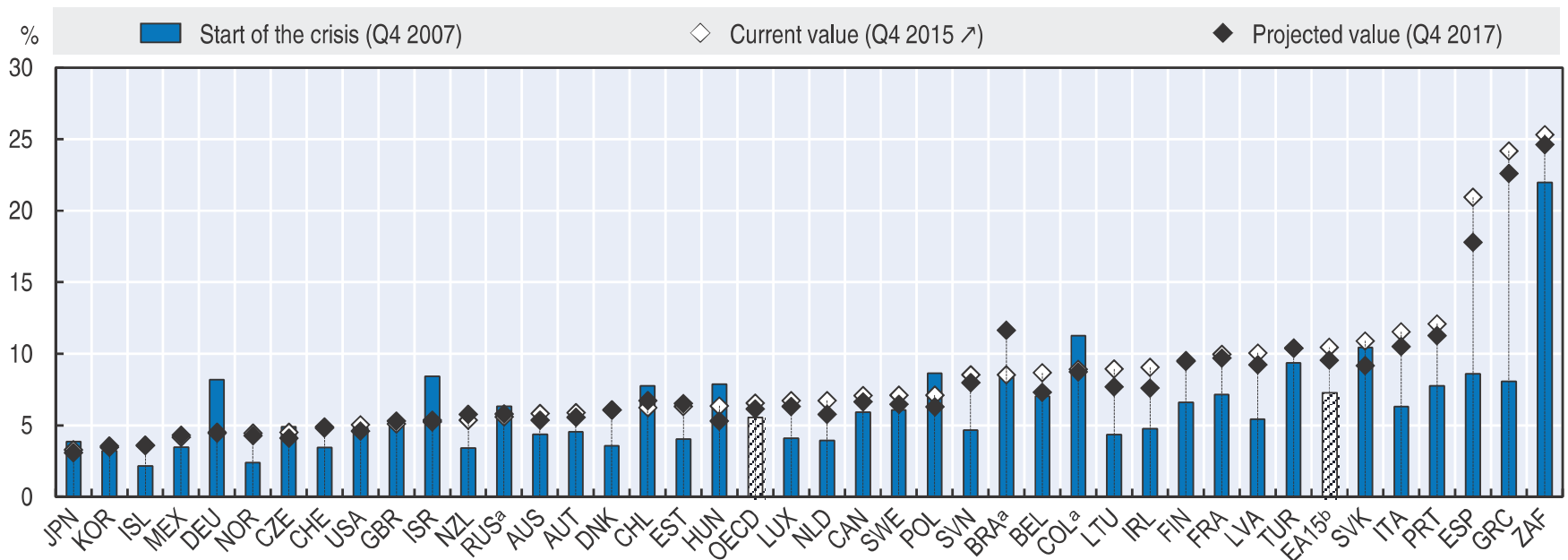
# Unemployment over time and across countries



- Unemployment rates vary a lot across countries and over time

# The impact of the crisis

Fig. Evolution of the unemployment rate, OECD, Q4 2007 – Q4 2017



# Supply and demand constraints

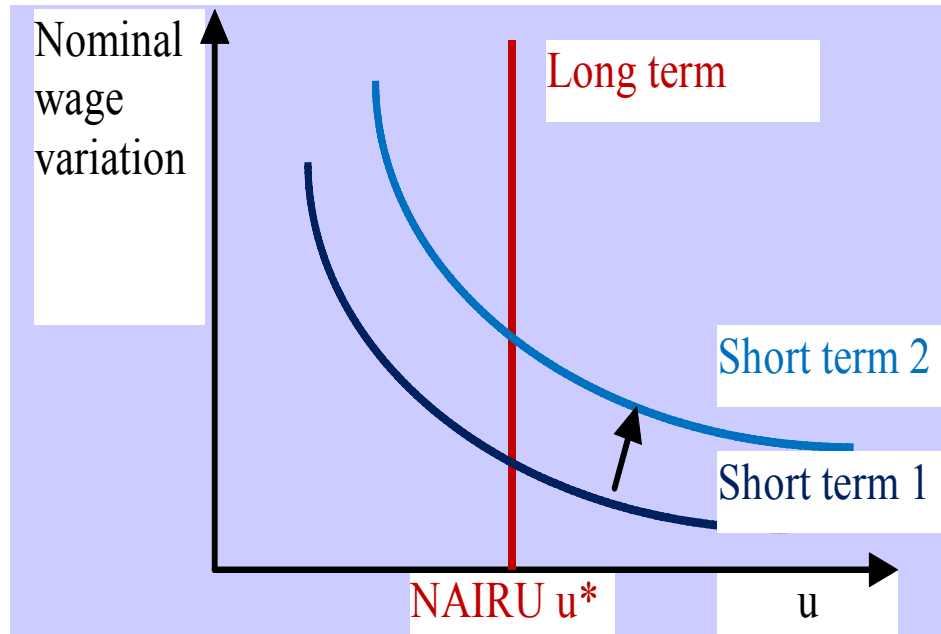
- Supply constraint (e.g. due to high real wage)
  - *classical unemployment*
  - => policies aimed at lowering labor costs
- Demand constraint (e.g. due to drop in consumption)
  - *keynesian unemployment*
  - => stimulus policies
- In the long run, supply and demand equalize
  - equilibrium unemployment ( $\neq$  full employment)
  - => ***labor market policies***



# Labor market policy (LMP)

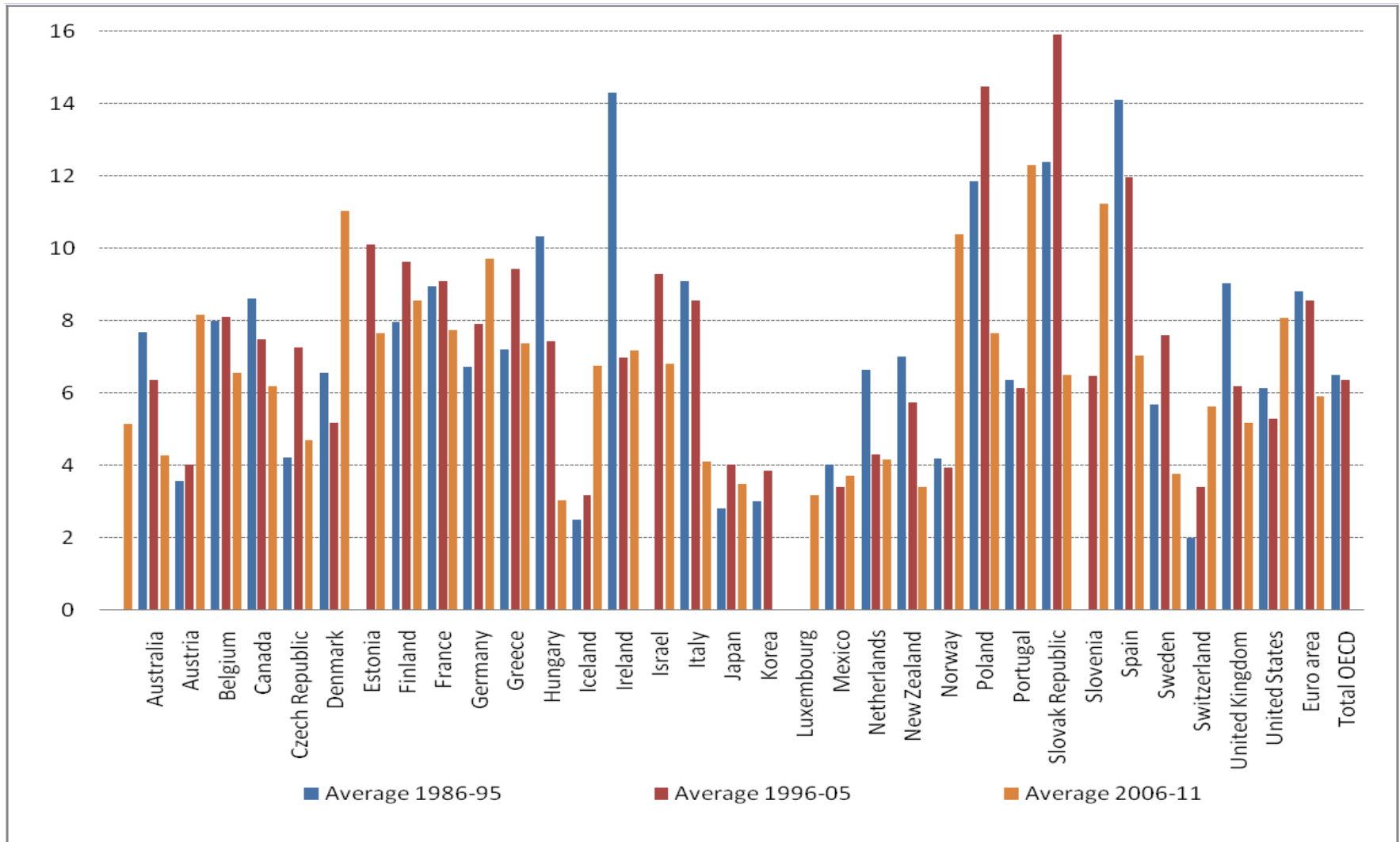
- LMP comprise policies that influence the interaction between supply and demand in order to enhance efficiency of job matching.
- How to assess labor market efficiency?
  - NAIRU rate
  - Beveridge curve

# The NAIRU

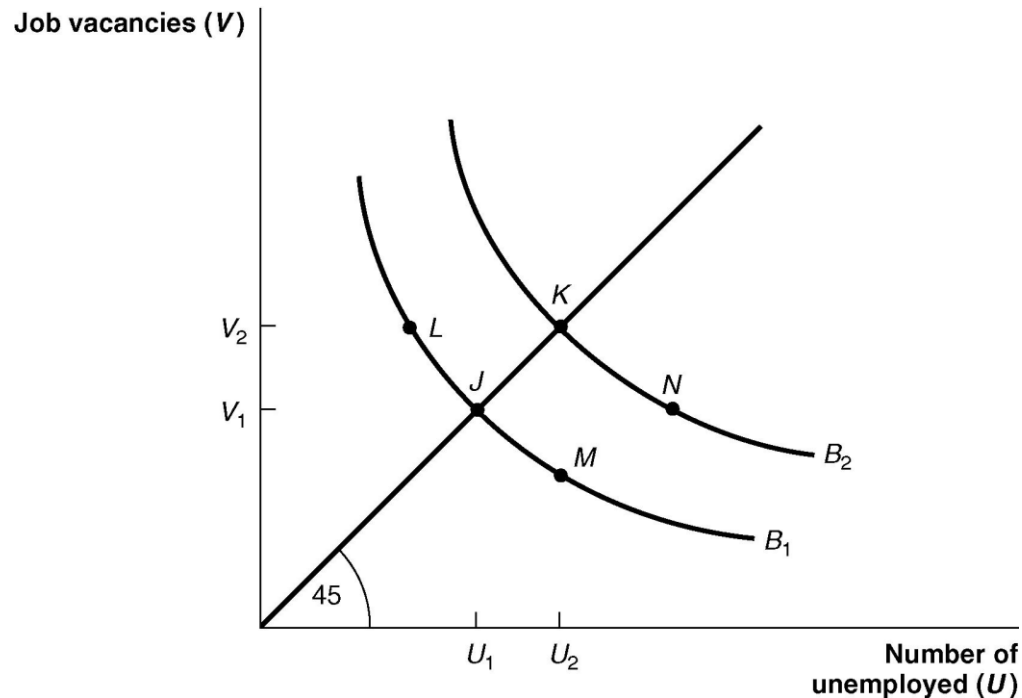


- Lower  $u^*$   $\Rightarrow$  labor market policy, structural policy
- Move  $u$  closer to  $u^*$   $\Rightarrow$  stabilization policy

# The NAIRU in OECD countries

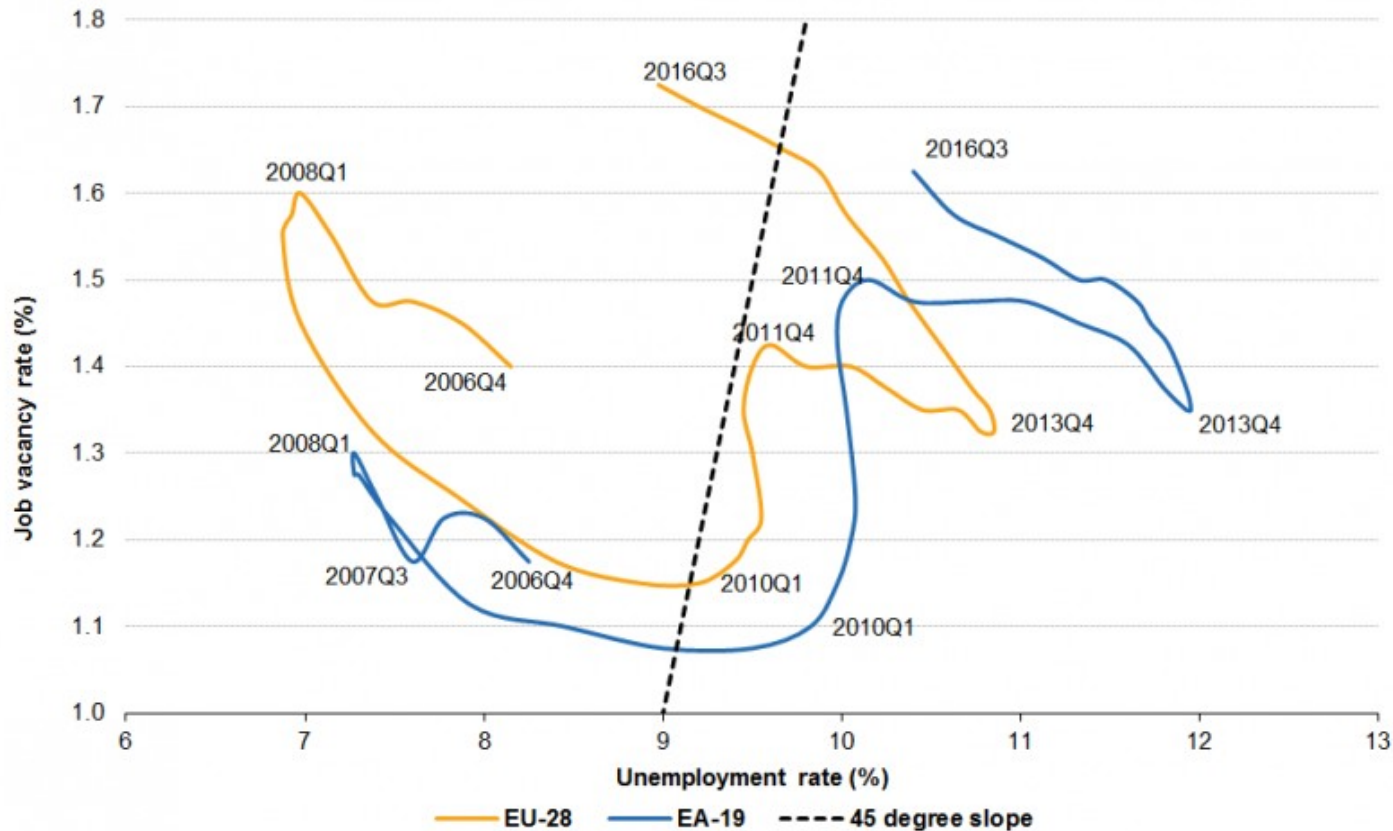


# The Beveridge curve (BC)



- Cyclical fluctuations move up and down the unemployment-vacancy combination along given BC.
- Change in the efficiency of the labor market cause shift of the BC.

# The Beveridge curve in EU



These shifts in the BC are suggestive of structural changes in the labor market.

# How to enhance efficiency of labor markets?

- Active labor market policy (ALMP)
- Regulations
  - Minimal wages
  - Regulations of dismissal
- Taxation
- Social policy incentives

# Active labor market policy

- ALMP is set of measures aiming to activate various groups of unemployment.
- Types of ALMP:
  - training
  - subsidized employment
  - public employment services
  - activation
- ALMPs may reduce mismatch in the labor market
- But these policies may lead to opposite results through *displacement effect, deadweight effect or substitution effect*.

Table Q. **Public expenditure in labour market programmes in OECD countries, 2013 and 2014**

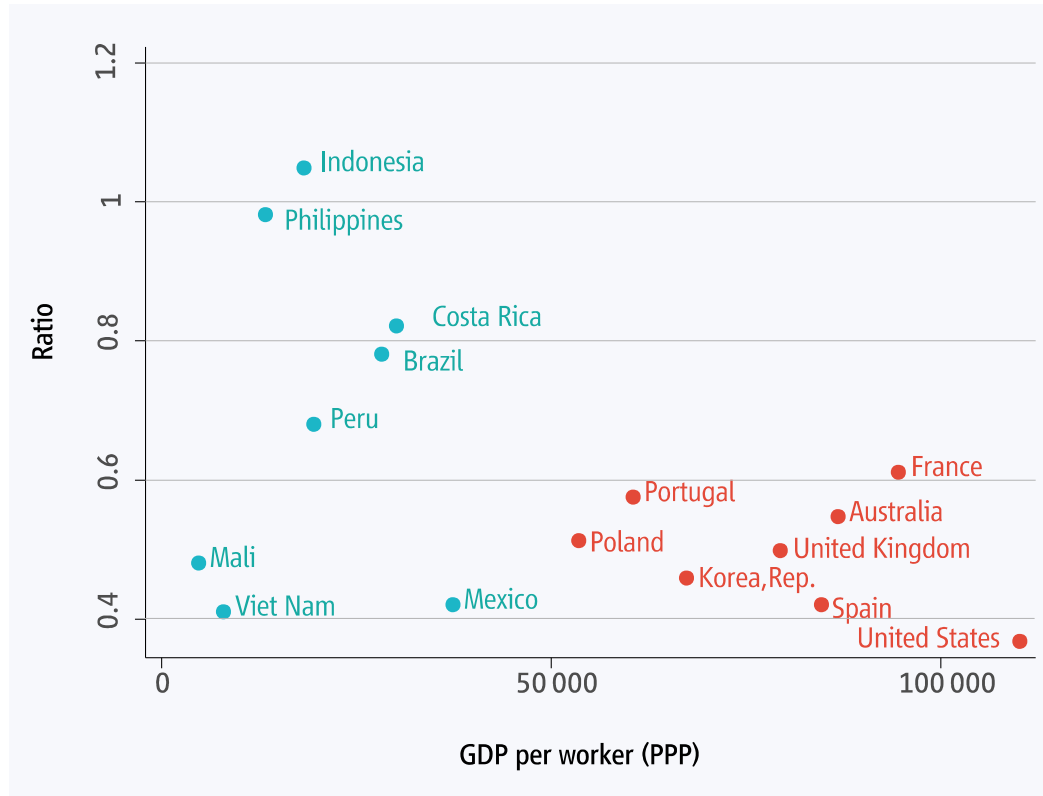
	Public expenditure (% of GDP)							
	Total		Active programmes		of which: Active measures not including PES and administration		Passive programmes	
	2013	2014	2013	2014	2013	2014	2013	2014
Australia	0.88	0.94	0.24	0.26	0.08	0.09	0.64	0.68
Austria	2.16	2.20	0.75	0.80	0.59	0.62	1.40	1.41
Belgium	2.77	2.65	0.72	0.74	0.52	0.52	2.05	1.91
Canada	0.80	0.79	0.24	0.22	0.14	0.12	0.57	0.57
Chile	0.36	0.42	0.10	0.11	0.07	0.08	0.26	0.31
Czech Republic	0.54	0.59	0.30	0.37	0.19	0.24	0.25	0.23
Denmark	3.45	3.33	1.81	1.91	1.49	1.60	1.65	1.42
Estonia	0.67	0.58	0.23	0.19	0.13	0.10	0.43	0.39
Finland	2.63	2.89	1.02	1.07	0.86	0.91	1.61	1.82
France	2.39	2.47	0.93	0.99	0.67	0.73	1.46	1.48
Germany	1.64	1.59	0.64	0.66	0.30	0.29	1.00	0.94
Greece	..	..	..	..	..	..	..	..
Hungary	1.12	1.12	0.78	0.86	0.70	0.77	0.34	0.26
Ireland	3.01	..	0.86	..	0.71	..	2.15	..
Israel	0.73	0.73	0.16	0.16	0.14	0.14	0.57	0.56
Italy	1.99	1.97	0.41	0.36	0.32	0.28	1.58	1.61
Japan	0.41	0.36	0.18	0.17	0.11	0.10	0.22	0.20
Korea	0.73	0.75	0.44	0.45	0.41	0.42	0.29	0.30
Luxembourg	1.47	1.41	0.62	0.65	0.58	0.60	0.85	0.76
Mexico	0.01	0.01	0.01	0.01	0.01	0.01	0.00	0.00
Netherlands	2.79	3.03	0.84	0.83	0.58	0.55	1.95	2.20
New Zealand	0.70	0.72	0.27	0.33	0.18	0.16	0.43	0.39
Norway	0.83	0.88	0.50	0.50	0.37	0.37	0.33	0.38
Poland	0.84	..	0.49	..	0.41	..	0.35	..
Portugal	2.15	1.89	0.50	0.57	0.46	0.53	1.65	1.32
Slovak Republic	0.62	0.55	0.22	0.20	0.17	0.16	0.40	0.35
Slovenia	1.18	0.98	0.38	0.37	0.28	0.28	0.80	0.61
Spain	3.37	..	0.50	..	0.42	..	2.87	..
Sweden	2.03	1.95	1.35	1.34	1.07	1.08	0.68	0.62
Switzerland	1.19	1.19	0.56	0.57	0.46	0.46	0.63	0.61
United Kingdom	..	..	..	..	..	..	..	..
United States	0.36	0.29	0.12	0.11	0.09	0.08	0.24	0.18
OECD	1.46	1.34	0.54	0.55	0.42	0.42	0.92	0.80
Latvia	0.54	0.53	0.23	0.17	0.19	0.14	0.31	0.36
Lithuania	0.46	0.43	0.24	0.24	0.19	0.18	0.22	0.19



# Minimum wages

- Most countries in the world have some form of minimum wage, the scale, eligibility and operational details change from country to country.
- A large body of theoretical and empirical research examines the effects of the minimum wage
  - In theory: no clear-cut predictions (depends on competitiveness of labor markets)
  - Empirical results: also point in both direction – positive and negative effects of the minimum wage on employment

# Ratio of minimum wages

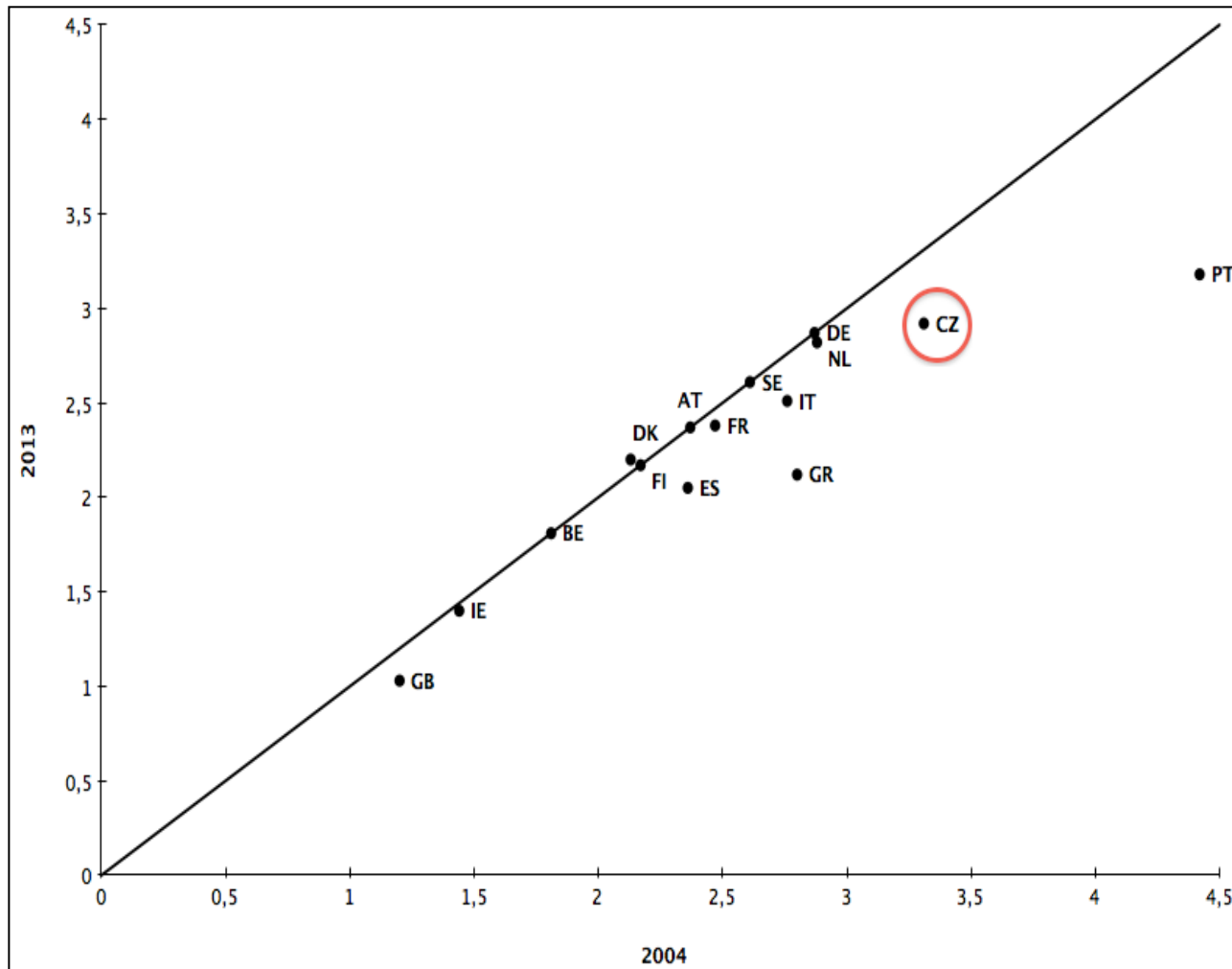


Sources: OECD: *Earnings: Minimum wages relative to median wages*, OECD Employment and Labour Market Statistics (database), 2015; U. Rani, P. Belser, M. Oelz and S. Ranjbar: "Minimum wage coverage and compliance in developing countries", in *International Labour Review*, 2013, Vol. 152, No. 3–4, pp. 411–442.

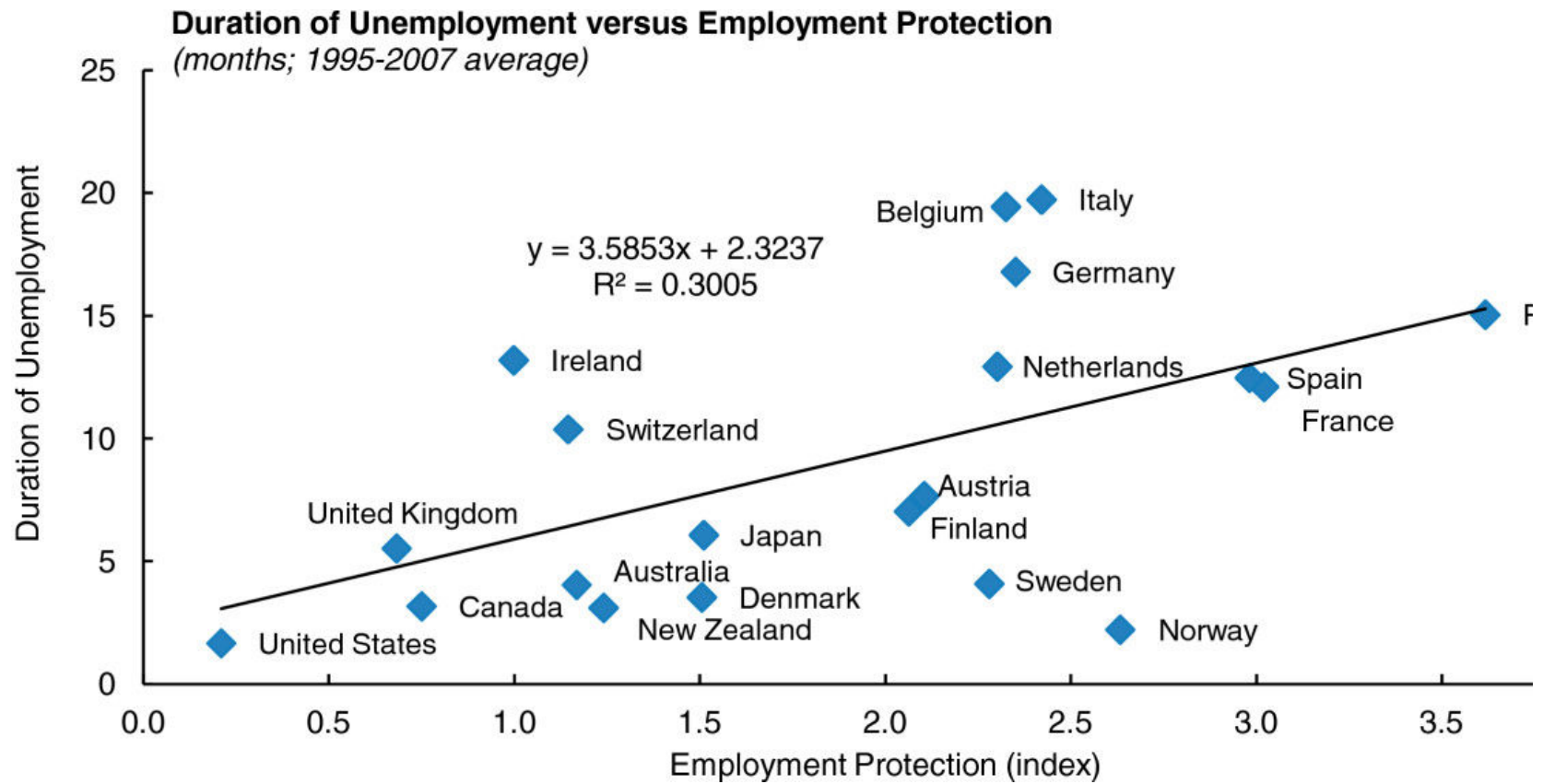
# Regulation of dismissal

- Employment protection legislation (EPL): legal restrictions on dismissals and compensations to workers in case of early termination of employment contract
- Severance regulations make it difficult for firms to reduce employment in the short run => firms are more reluctant to hire in good times
- Empirical results:
  - EPL negatively affects unemployment inflows and outflows
  - countries with stricter EPL display higher youth unemployment rates and lower unemployment among prime-aged groups

# Change in EPL index (regular contracts)

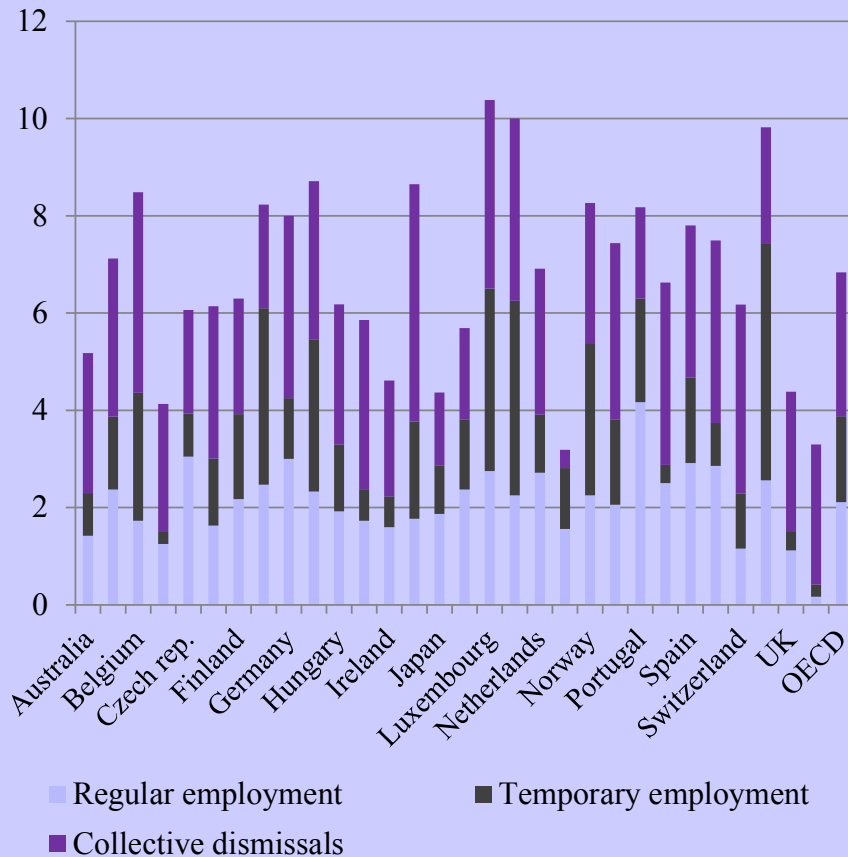


# Employment protection and duration of unemployment

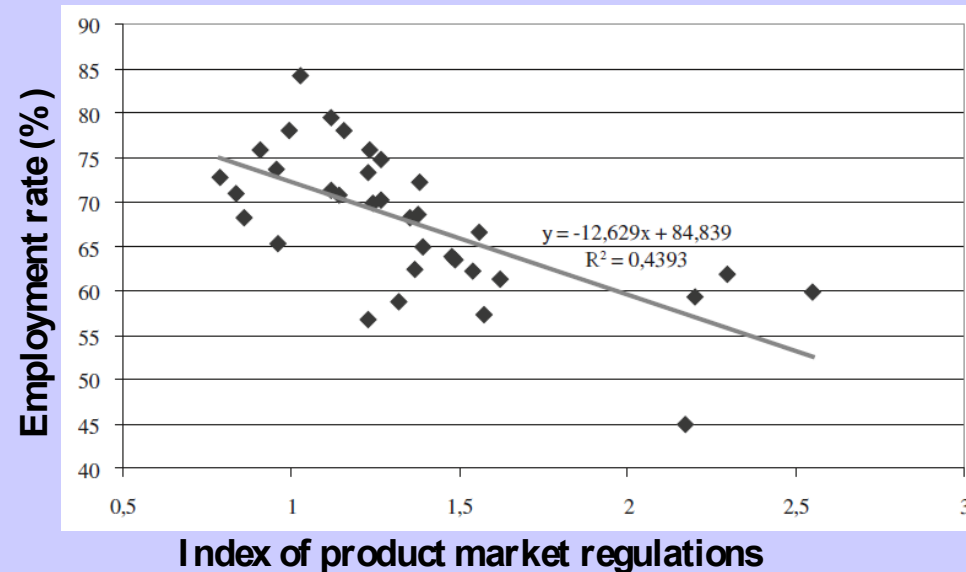


# Labor and product market regulation

## Labor-market regulation



## Product-market regulation and employment rate



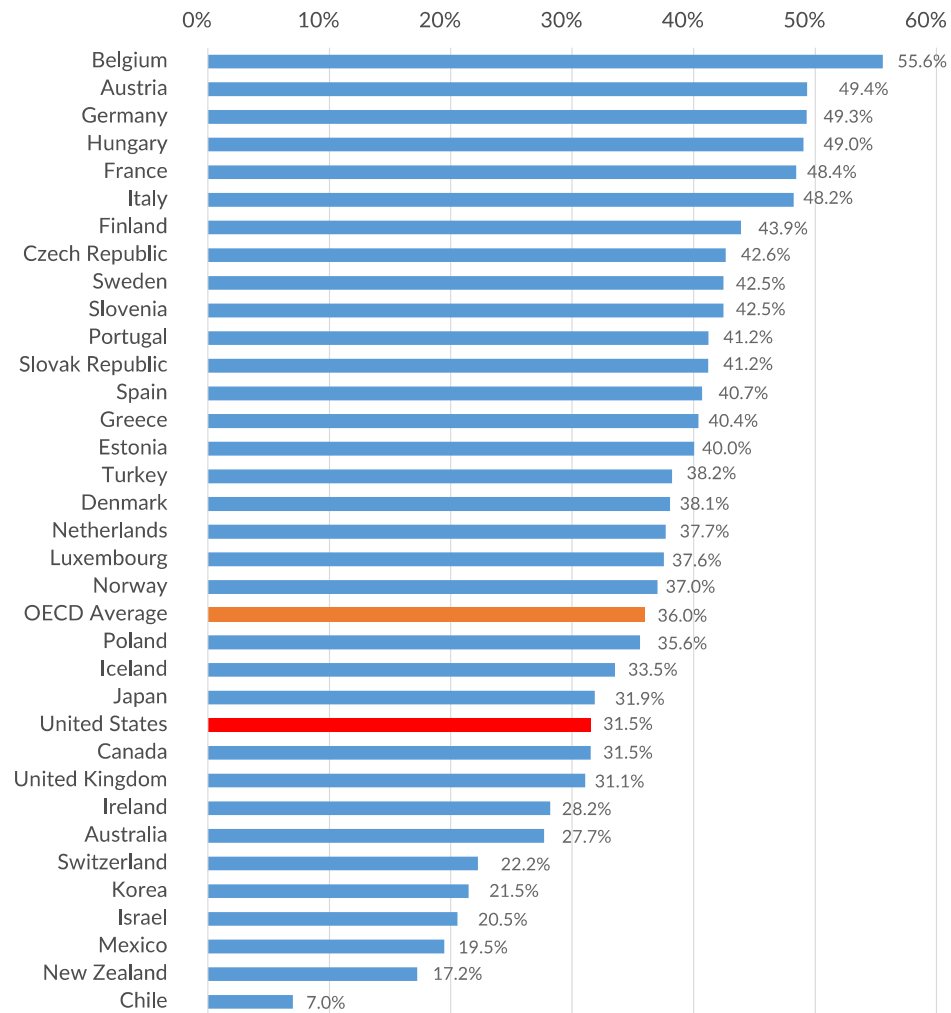
Index of product market regulations

Source: OECD, year 2008

# Labor taxation

- Labor is subject not only to income taxes paid by households but also to a number of social security contributions by both employees and employers.
- Higher taxes raise the real cost of labor faced by firms, leading to lower employment in the sector that pays the tax.
- Net effect depends on the elasticity of labor demand and supply.
  - In Europe: wages are set in collective bargaining => flatter labor supply curve => stronger impact on employment

# Total tax wedge on a single worker (OECD, 2014)





# Social policy incentives

- Taking up a job not only means receiving salary but also paying taxes (if the salary is high enough) and losing eligibility in income maintenance program => some people can be worse off by taking a job.
- Safety net programmes may lead to a *welfare trap*, inducing people to remain unemployed or stay out of the labor force.
- Experiences of 'work-to-welfare' in UK and USA indicate the importance of this incentive aspect.



# How generous are unemployment benefits?

Net household income when out of work as percentage of net household income when in work (based on country average wage). Data is for a one-earner couple with two children in 2014.

Source: OECD



Net replacement rates for one-earner couple with two children.



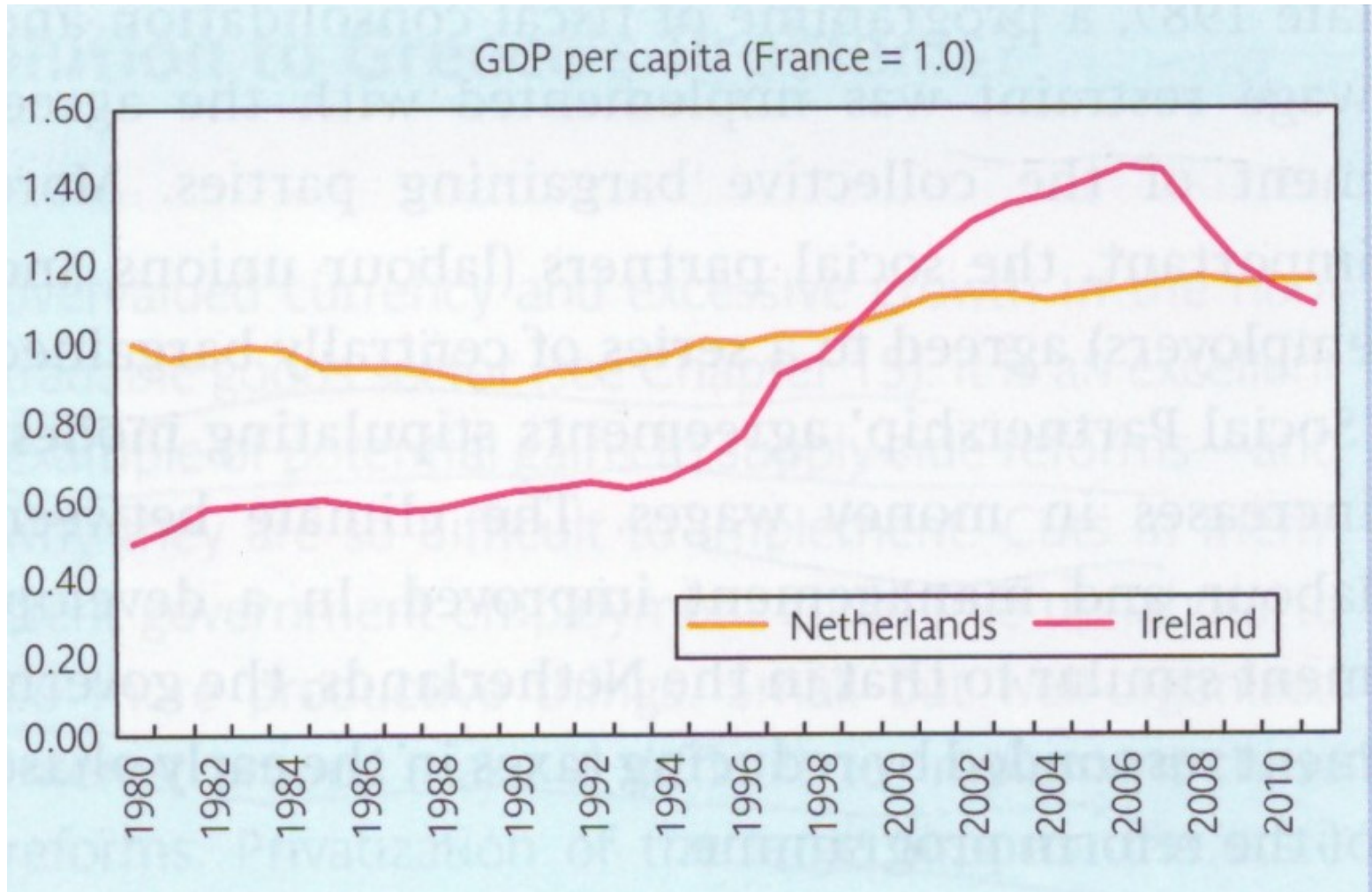
# Feasible supply-side policy: peanuts or big payoffs?

- **The case of Netherlands:**
- During the 70s the Netherlands was the mother of the Dutch disease, unemployment almost reached 12 % in 1983. A generous social system was proving unsustainable at those rates of unemployment.
- Wassenaar Accord in 1982: long-term agreement between social partners which moderated real wage growth, better treated part-time employment and lower labor taxation
- Employment agencies provided more carrot-and-stick incentives for the unemployed to return to work.

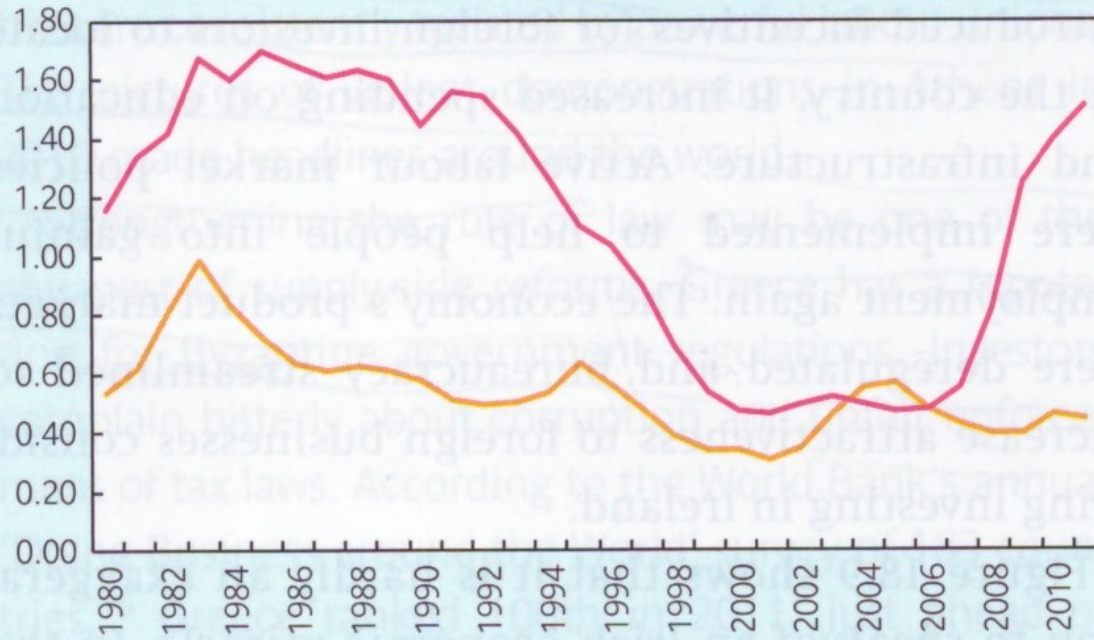
# Feasible supply-side policy: peanuts or big payoffs?

- **The case of Ireland**
- Anaemic growth rates, high budget deficits and unemployment reaching 18 % in the late 1980s.
- R. Dornbusch: “Ireland is a sick man of Europe”.
- In the late 1980s: programme of fiscal consolidation was adopted, social partners agreed on stipulating modest increase in money wages, government reduced labor taxation
- In the early 90s: ALMPs were implemented, products market deregulated.

# Results



Unemployment rate (France = 1.0)



Employment/Population (France = 1.0)

