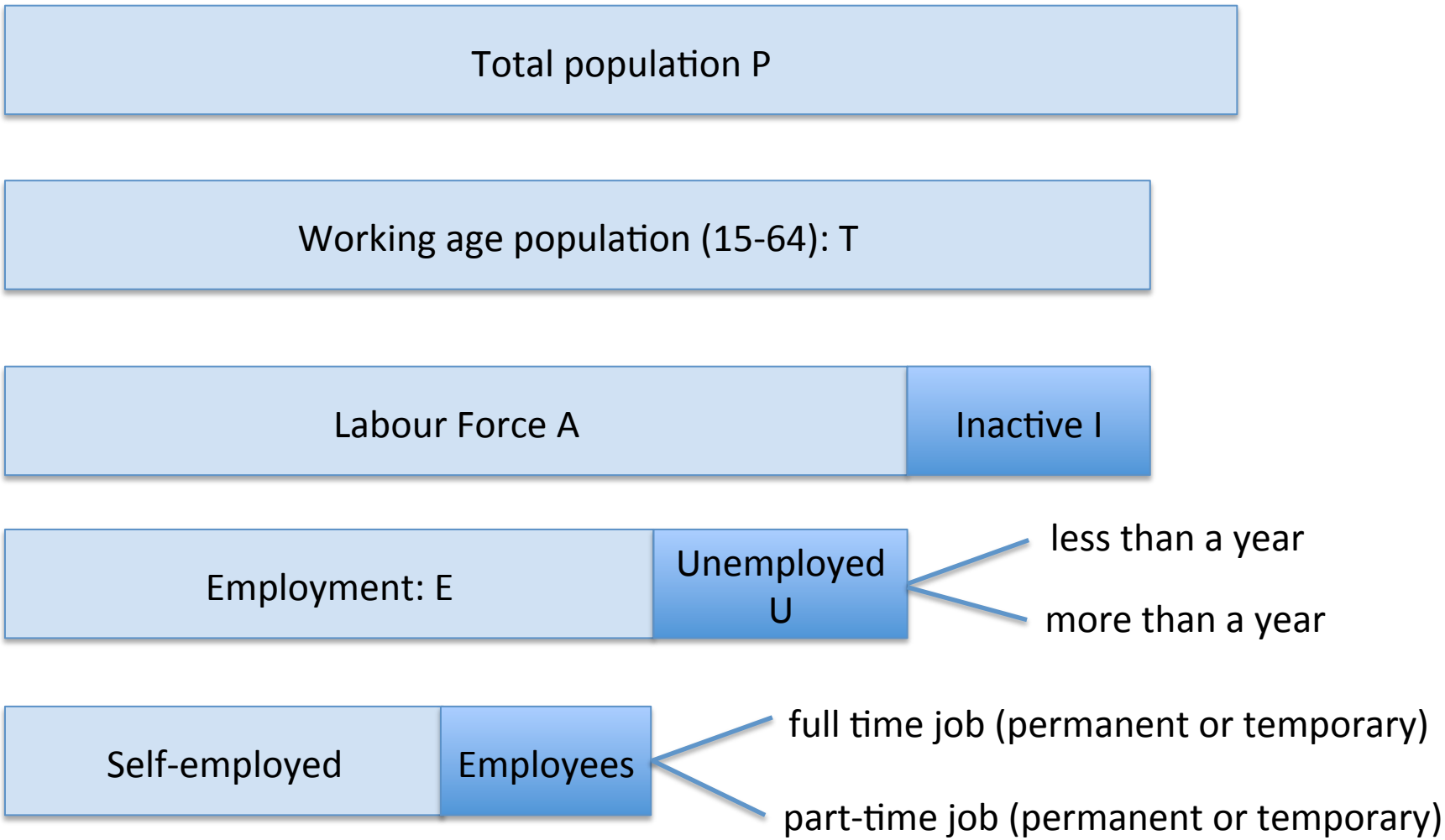
Economic Policy #08

Labour Market Policy

Labour Market Policy

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

Definitions



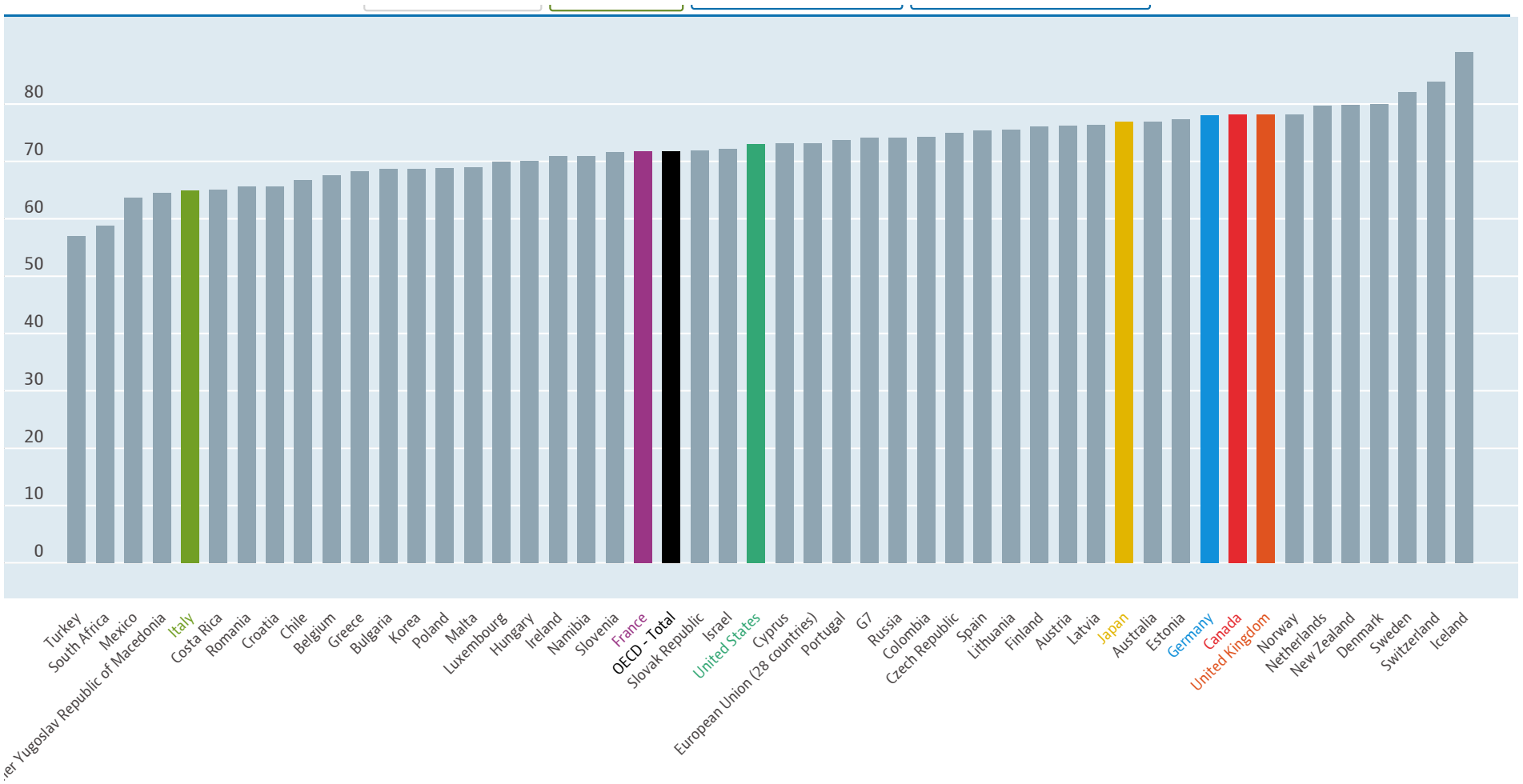
Basic indicators

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

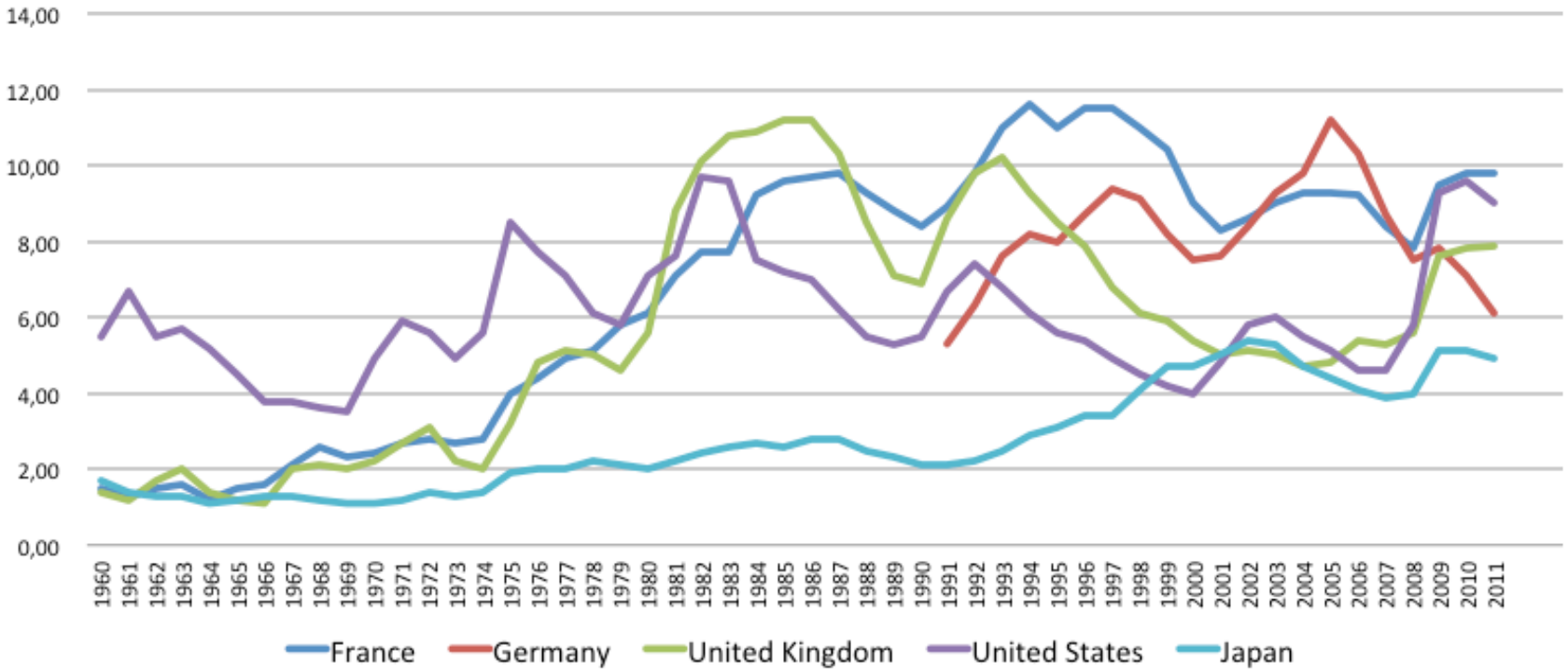
EU-27 (2016)

- 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)



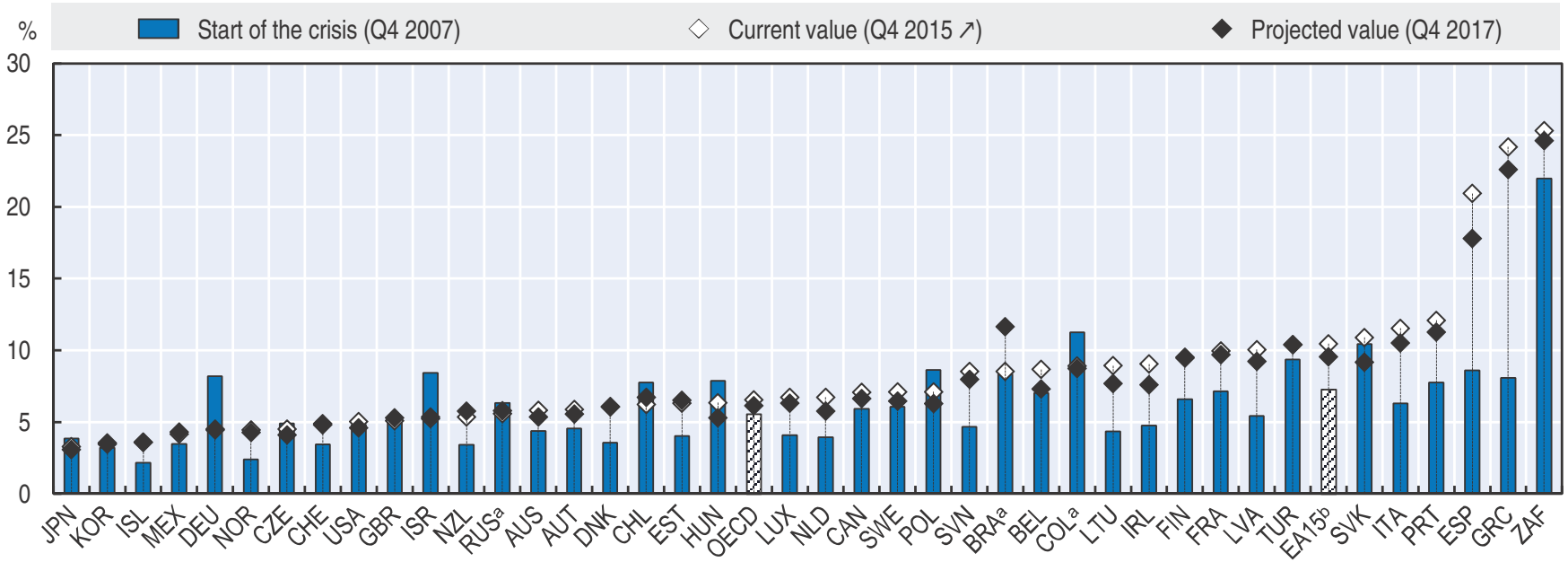
Unemployment over time and across countries



- 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



Active labor market policy

- ALMP is set of measures aiming to activate various groups of unemployment and reducing mismatch in the labor market
- Types of ALMP:
  - training
  - subsidized employment
  - public employment services
  - activation

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

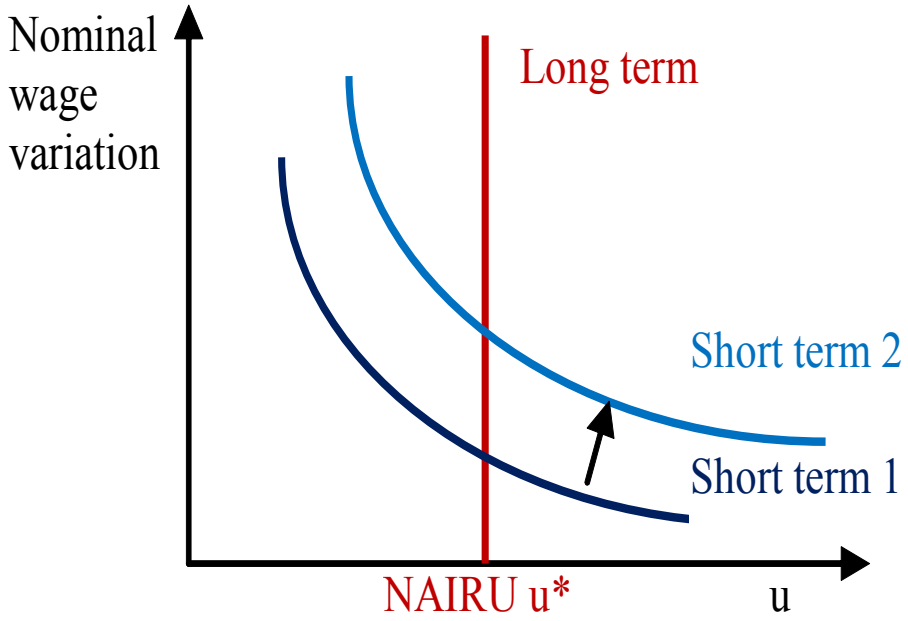
	Public expenditure (% of GDP)							
	Total		Active programmes		*of which:* Active measures not including PES and administration		Passive programmes	
	2013	2014	2013	2014	2013	2014	2013	2014
Australia	0.88	0.94	0.24	0.26	0.08	0.09	0.64	0.68
Austria	2.16	2.20	0.75	0.80	0.59	0.62	1.40	1.41
Belgium	2.77	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

Efficiency of ALMP

- How to assess labor market efficiency?
  - NAIRU rate
  - Beveridge curve

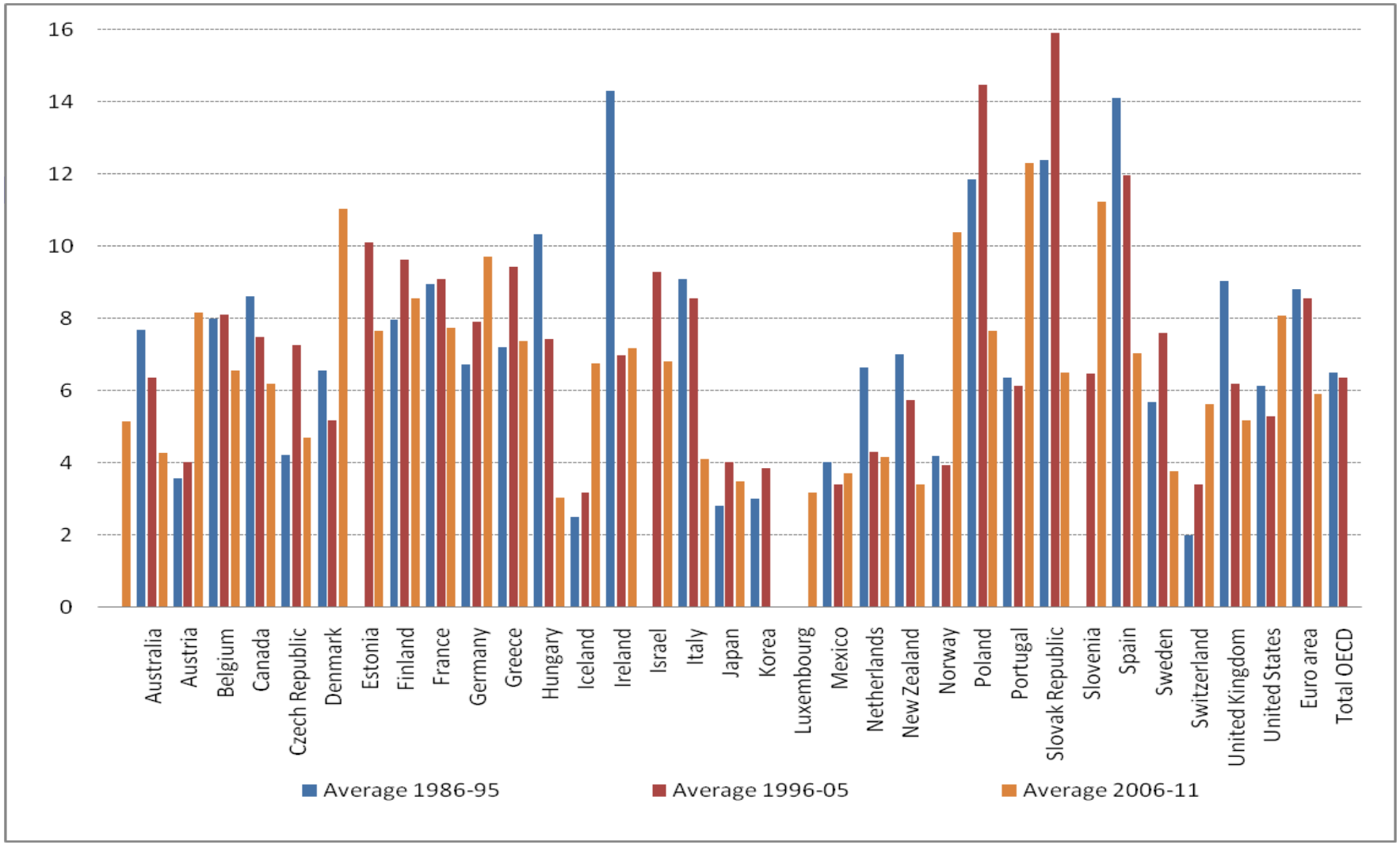
- These policies may lead to opposite results through *displacement effect*, *deadweight effect* or *substitution effect*.

The NAIRU

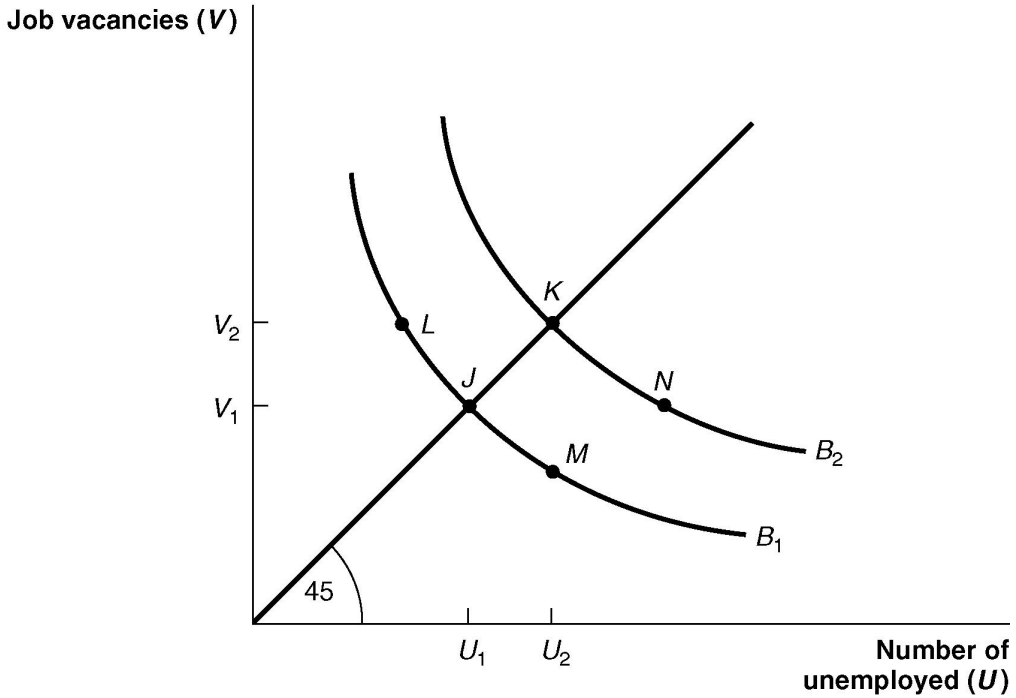


- Lower *u** => labor market policy, structural policy
- Move *u* closer to *u** => stabilization policy

The NAIRU in OECD countries

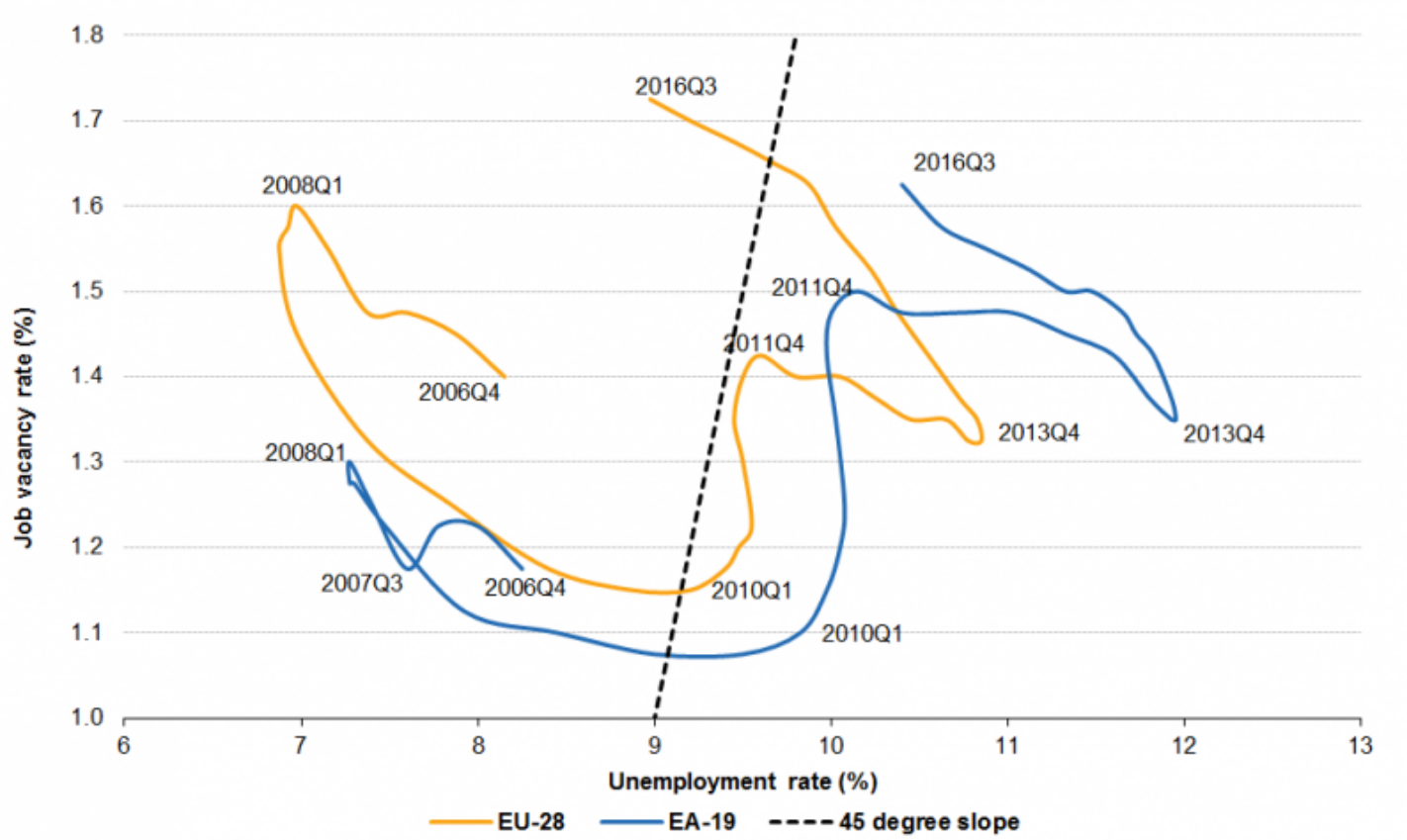


The Beveridge curve (BC)



- 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.

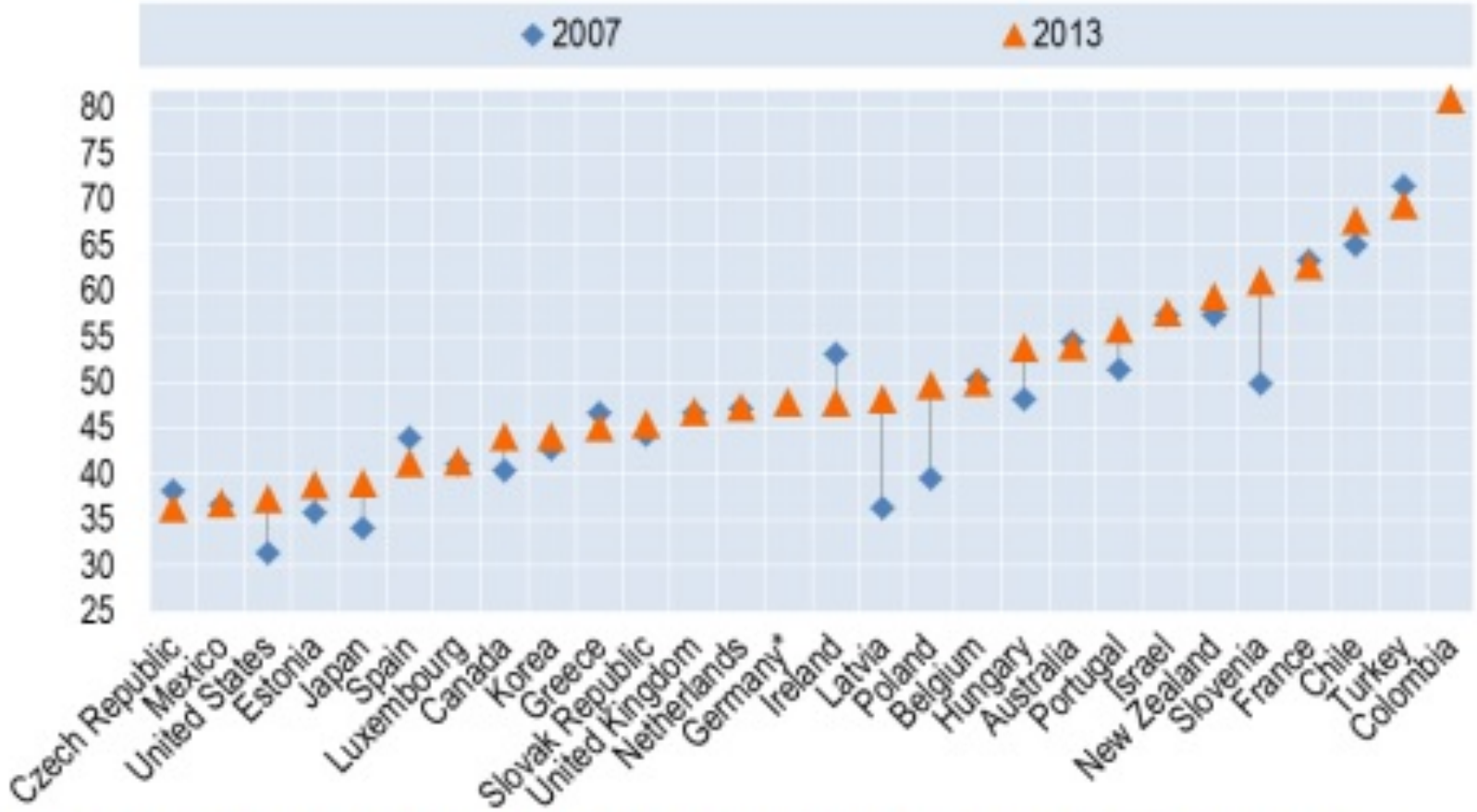
Labor market regulations

- Regulation of dismissal
- Minimal wages
- Taxation
- Social policy incentives

Minimal 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

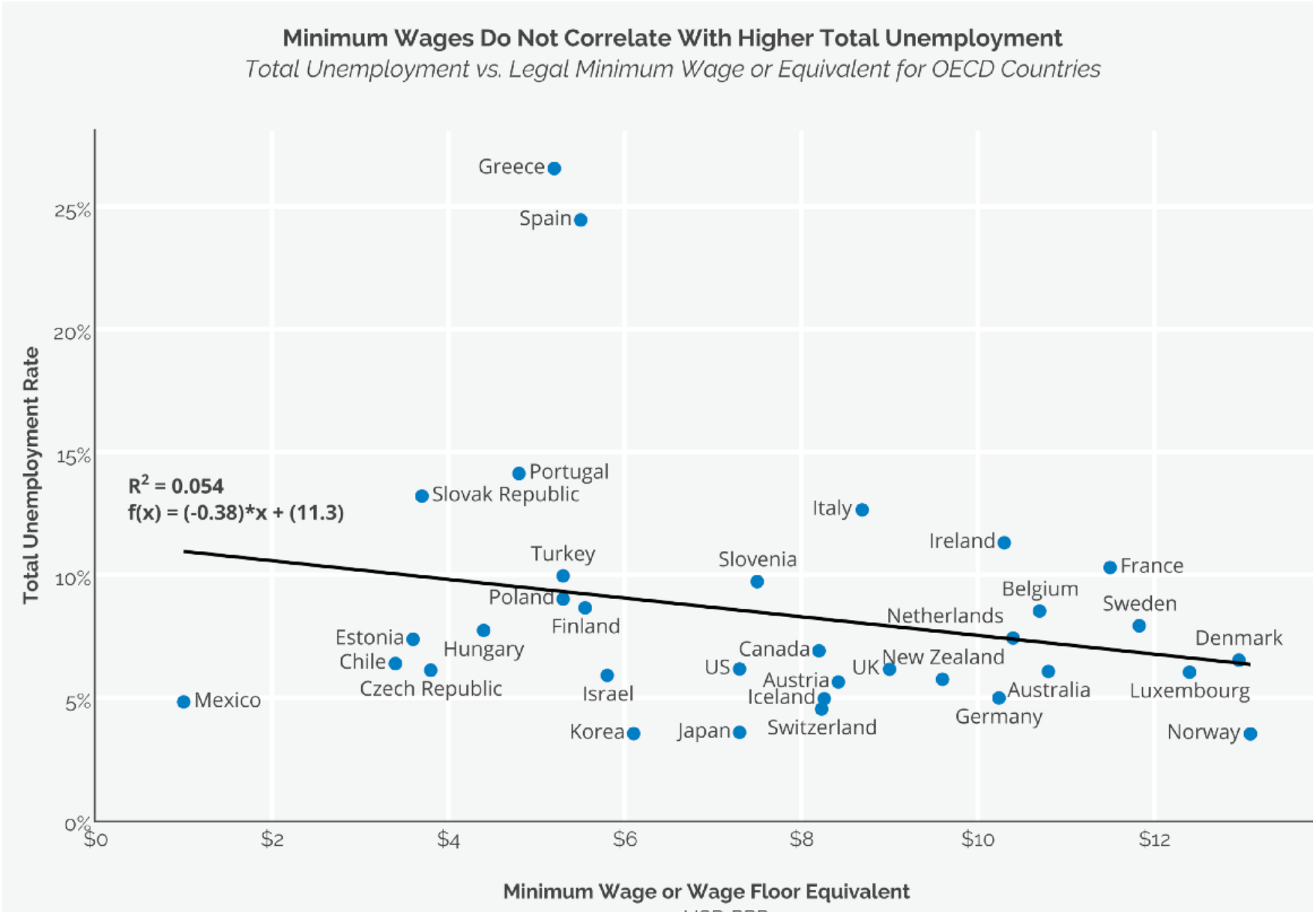
(b) Minimum-wage levels before taxes: percentage of median wage, pre-crisis and latest



Notes: Levels refer to full-time workers. Panel (b) also shows data for Colombia and Latvia, who are currently seeking OECD membership.

* Germany: Minimum-wage level 2015 is expressed in percentage of the projected 2015 median wage. Projections are based on earnings data from the OECD Economic Outlook database.

Source: OECD Earnings and Minimum Wage databases, www.oecd.org/employment/database.


Minimum Wages Do Not Correlate With Higher Total Unemployment
Total Unemployment vs. Legal Minimum Wage or Equivalent for OECD Countries
Total Unemployment Rate
25%
20%
15%
10%
5%
0%
$0
$2
$4
$6
$8
$10
$12
Minimum Wage or Wage Floor Equivalent
R² = 0.054
f(x) = (-0.38)*x + (11.3)
Greece
Spain
Portugal
Slovak Republic
Italy
Ireland
Turkey
Slovenia
France
Poland
Belgium
Sweden
Finland
Netherlands
Estonia
Hungary
Canada
Denmark
Chile
US
UK
New Zealand
Czech Republic
Israel
Austria
Australia
Luxembourg
Mexico
Iceland
Germany
Korea
Japan
Switzerland
Norway

CS. Studies based on natural experiments

- D. Card and A. Krueger: Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania. American Economic Review 84(4), September 1994: 772-793
- Research question: How do employers in a low-wage labor market respond to an increase in the minimum wage?
- Approach: Compare employment of teenagers in New Jersey and eastern Pennsylvania before and after the increase in the minimum wage in NJ from $4.25 to $5.05 on April 1, 1992.

CS. Studies based on natural experiments (cont.)

- Data: Phone survey of fast-food restaurants in NJ and eastern Pennsylvania
- Results of difference-in-differences approach:

Employment in Typical Fast-Food Restaurants

	NJ	E Penn
Before change	20.4	23.3
After change	21.0	21.2
Difference	0.6	-2.1

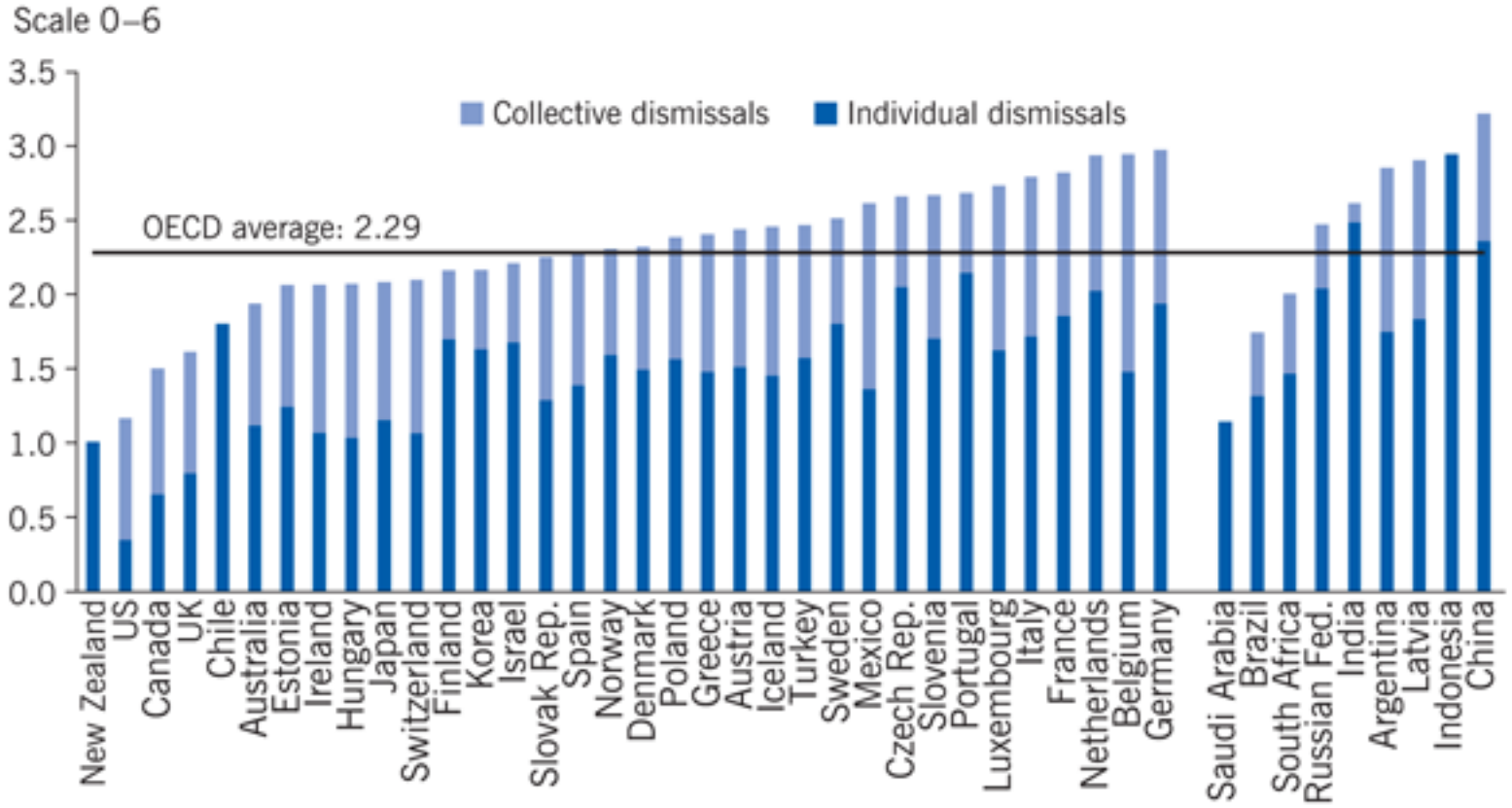
Difference-in-Differences = 0.6 – (-2.1) = **2.7**

Regulation of dismissal

- Employment protection legislation (EPL): legal restrictions on dismissals and compensations to workers in case of early termination of employment contract

- The OECD uses following indicators:
  - Regulations under permanent contract
  - Strictness of collective dismissals
  - Regulations under temporary contracts

Figure 1. Protection of permanent workers against individual and collective dismissal varies widely

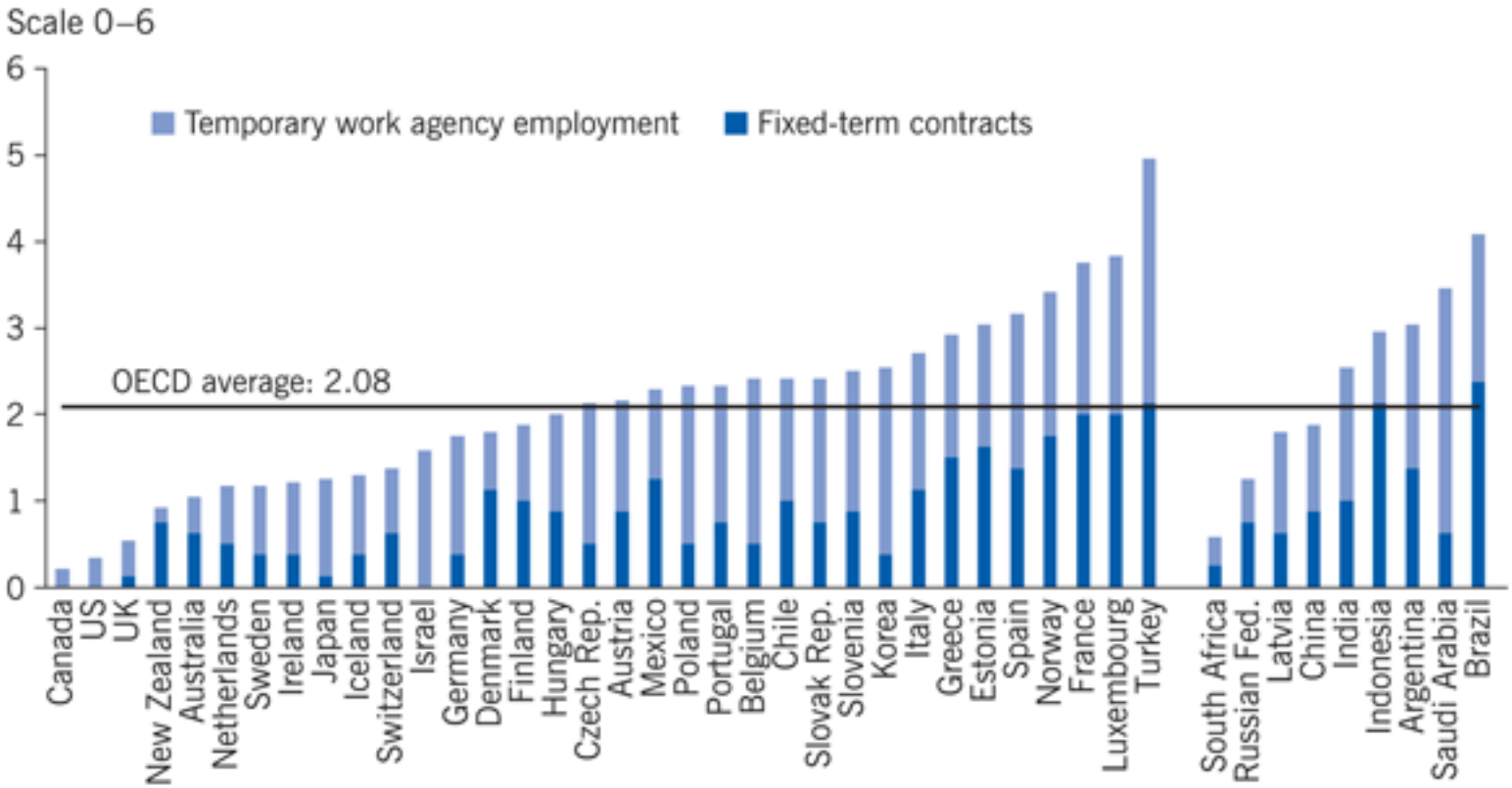


Notes: Data refer to 2013 for OECD countries and Latvia and 2012 for other countries. The height of the bar represents the value of the overall indicator on a scale of least stringent (0) to most stringent (6).

Source: OECD. *Employment Outlook*. Paris: OECD Publishing, 2013 [2]; data for Israel, http://dx.doi.org/10.1787/888932315602.

IZA World of Labor

Figure 2. Regulation of temporary contracts also varies widely

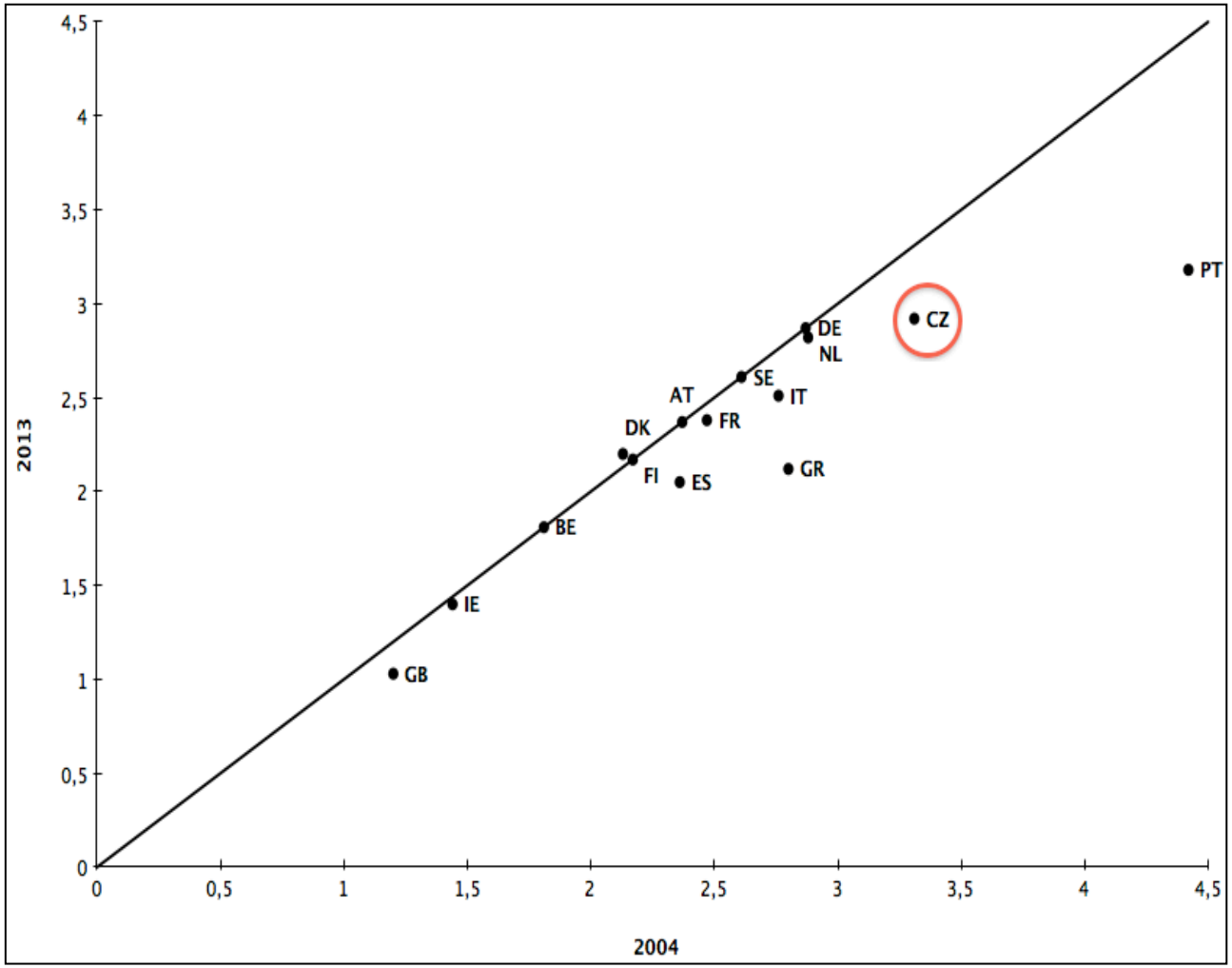


Notes: Data refer to 2013 for OECD countries and Latvia and to 2012 for other countries. The height of the bar represents the value of the overall indicator on a scale of least stringent (0) to most stringent (6).

Source: OECD. *Employment Outlook*. Paris: OECD Publishing, 2013 [2]; data for Israel, http://dx.doi.org/10.1787/888932315602.

IZA World of Labor

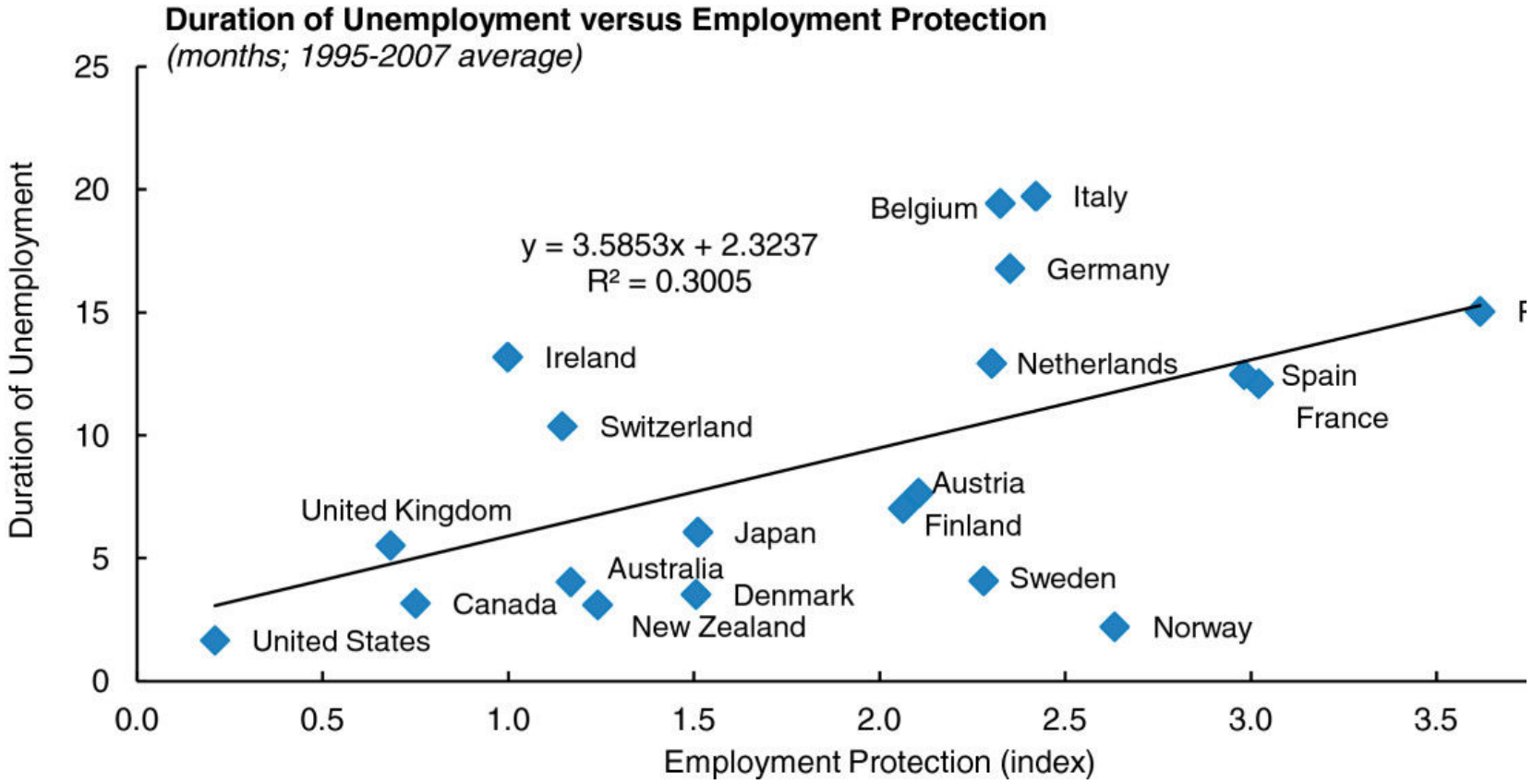
Change in EPL index (regular contracts)



Employment protection legislation: consequences

- 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 dislay higher youth unemployment rates and lower unemployment among prime-aged groups

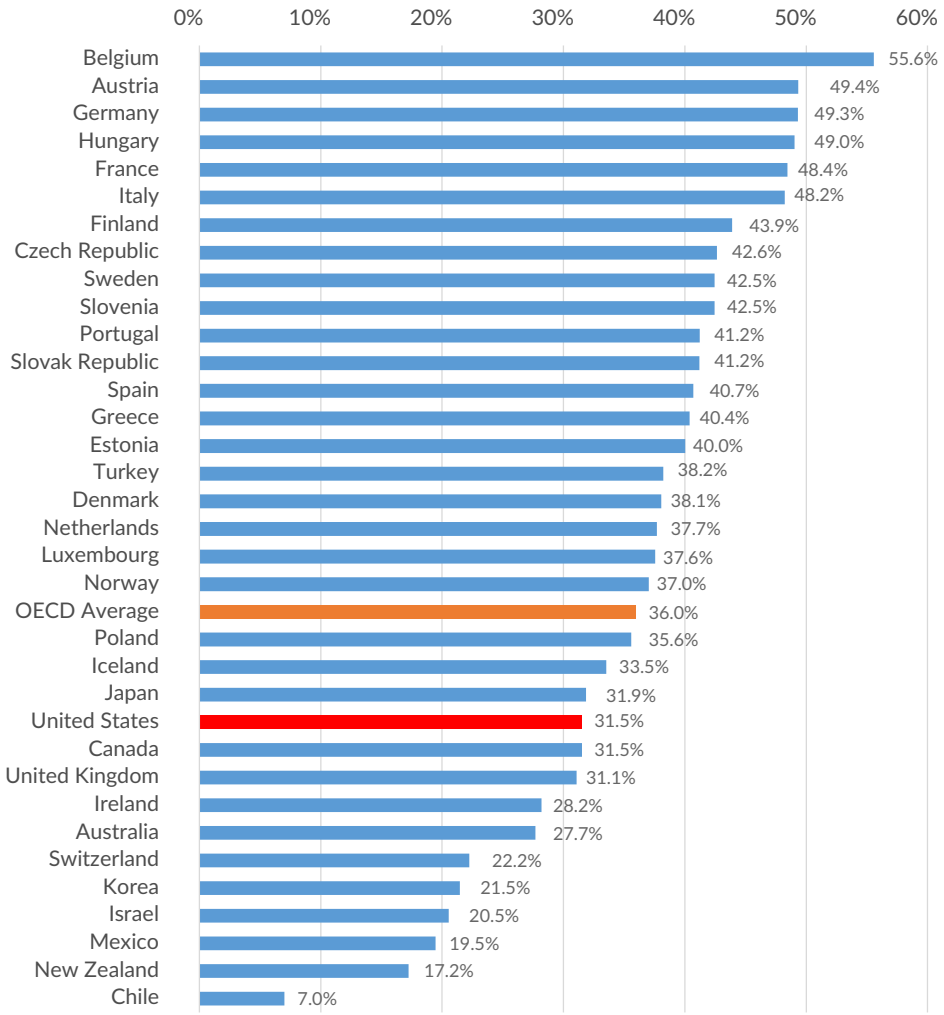
Employment protection and duration of unemployment



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

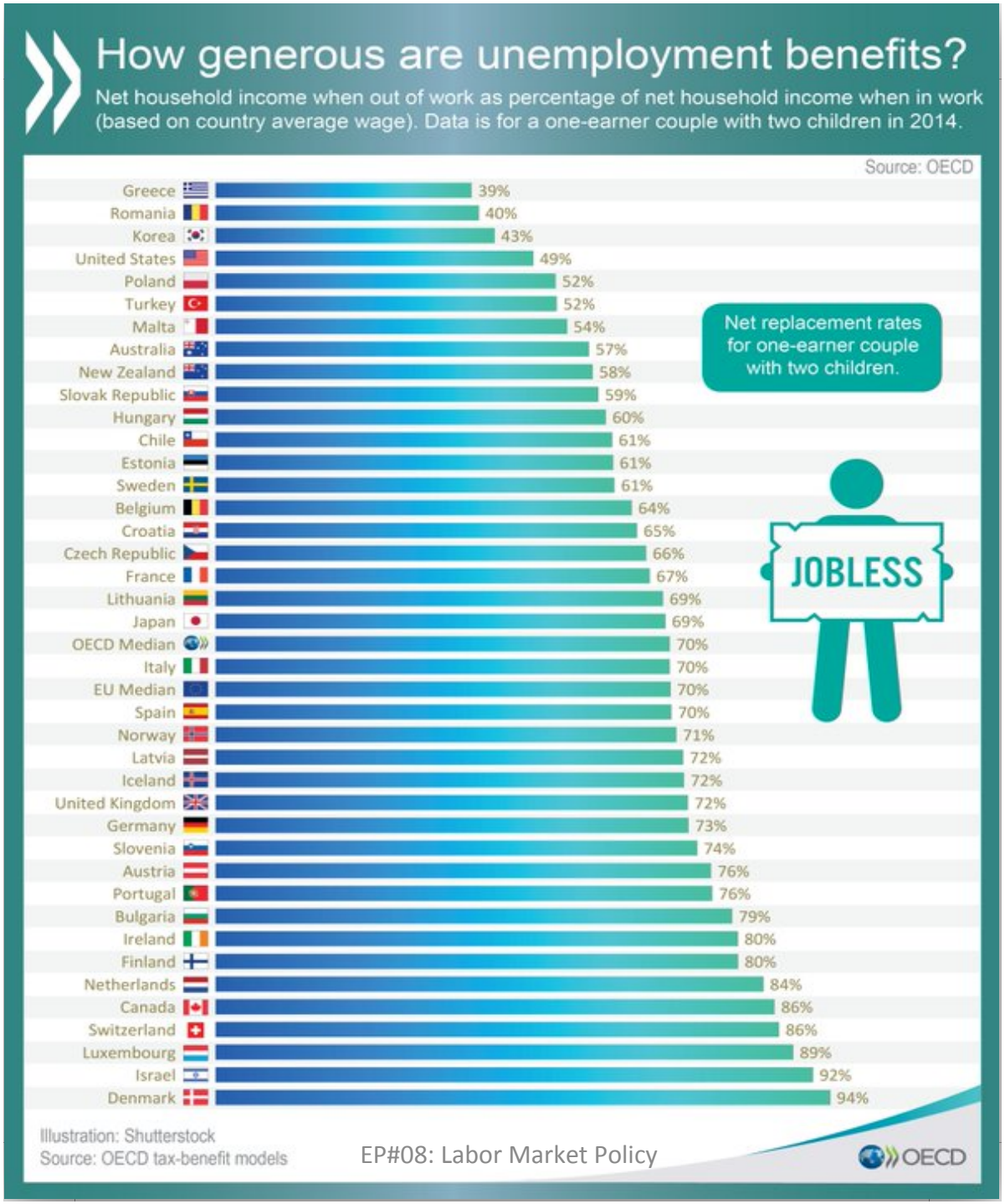
Total tax wedge on a single worker (OECD, 2014)



Source: OECD Taxing Wages, 2015.

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 by 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 indicates 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
Greece 39%
Romania 40%
Korea 43%
United States 49%
Poland 52%
Turkey 52%
Malta 54%
Australia 57%
New Zealand 58%
Slovak Republic 59%
Hungary 60%
Chile 61%
Estonia 61%
Sweden 61%
Belgium 64%
Croatia 65%
Czech Republic 66%
France 67%
Lithuania 69%
Japan 69%
OECD Median 70%
Italy 70%
EU Median 70%
Spain 70%
Norway 71%
Latvia 72%
Iceland 72%
United Kingdom 72%
Germany 73%
Slovenia 74%
Austria 76%
Portugal 76%
Bulgaria 79%
Ireland 80%
Finland 80%
Netherlands 84%
Canada 86%
Switzerland 86%
Luxembourg 89%
Israel 92%
Denmark 94%
Net replacement rates for one-earner couple with two children.
JOBLESS
Illustration: Shutterstock
Source: OECD tax-benefit models
OECD

C.S. Feasible supply-side policy: lessons from history

- **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.

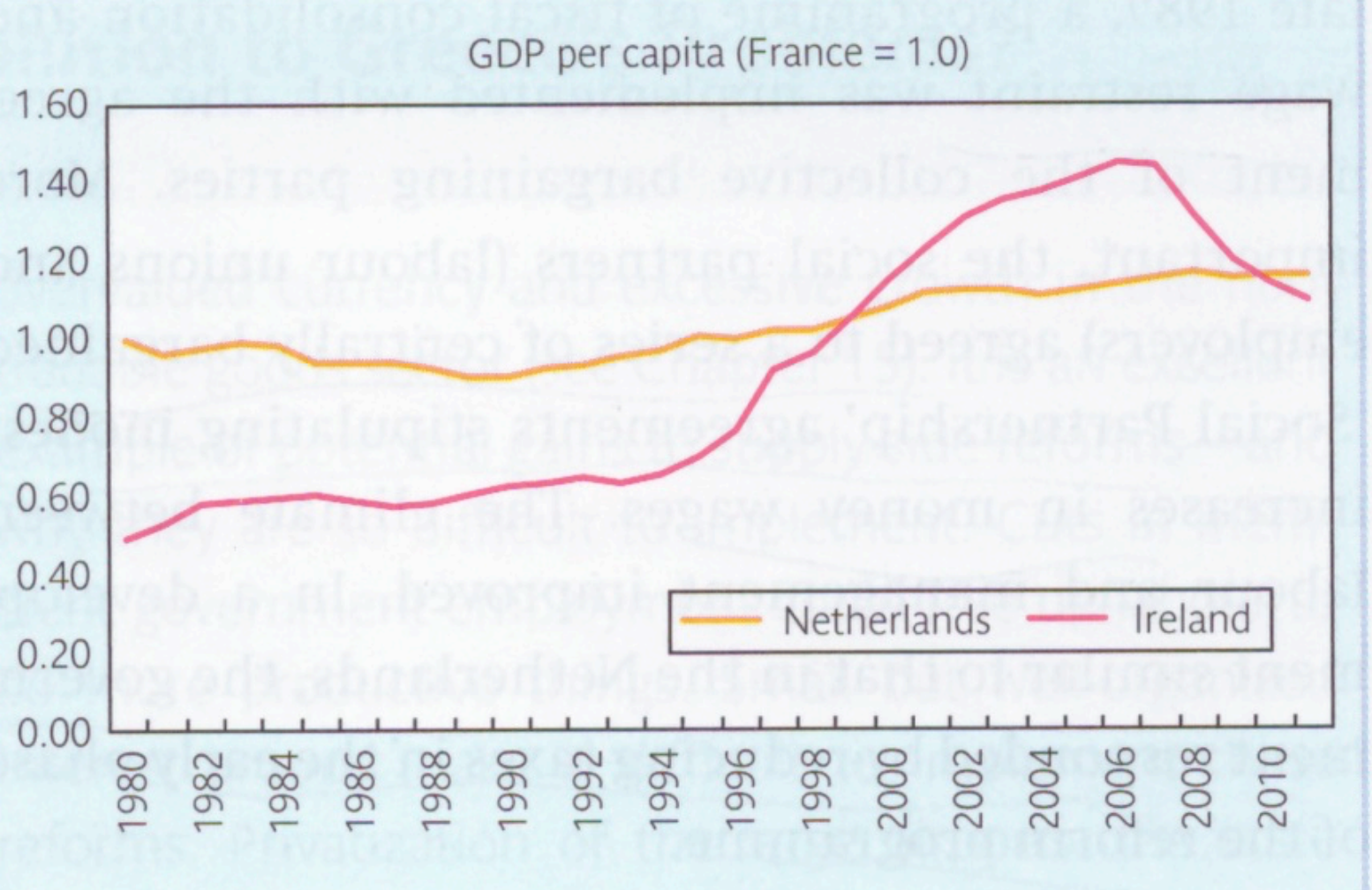
Source: Burda&Wyplosz (2012)

C.S. Feasible supply-side policy: lessons from history

- **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.

Source: Burda&Wyplosz (2012)

Results



Source: Burda&Wyplosz (2012)