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THE ROLE OF LABOUR MARKET INSTITUTIONS IN EXPLAINING LABOUR MARKET RIGIDITIES. THE CASE OF UNEMPLOYMENT BENEFITS

Labour market rigidities are characterized with a number of indicators. Institutional differences across countries represent a source of labour market rigidity. There are substantial differences across countries in labour market institutions in terms of hiring and firing protection legislation, atypical employment, minimum wage, duration and amount of unemployment benefits. The main focus is on the evolution of labour market institutions, which are among candidate explanations for the very diverse trajectories of labour markets in the European Union countries and especially on unemployment benefits.

Keywords: labor market, unemployment, legislation, EU.

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РОЛЬ ІНСТИТУТІВ РИНКУ ПРАЦІ В ПОЯСНЕННІ НЕЕЛАСТИЧНОСТІ РИНКУ ПРАЦІ (НА ПРИКЛАДІ ВИПЛАТ ПО БЕЗРОБІТТЮ)

У статті показано, що нееластичність ринку праці характеризується рядом показників. Інституційні відмінності між країнами є джерелом нееластичності ринку праці. У різних країнах існують значні відмінності в інститутах ринку праці в плані законодавства про найм/звільнення, нетипової зайнятості, мінімальної зарплати, термінів виплати і розмірів виплат по безробіттю. Основне питання при цьому — еволюція інститутів ринку праці, чиєю діяльністю можуть бути пояснені великі відмінності між ринками праці в ЄС, особливо щодо виплат по безробіттю.

Ключові слова: *ринок праці, законодавство, безробіття, ЄС.*

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РОЛЬ ИНСТИТУТОВ РЫНКА ТРУДА В ОБЪЯСНЕНИИ НЕЭЛАСТИЧНОСТИ РЫНКА ТРУДА (НА ПРИМЕРЕ ВЫПЛАТ ПО БЕЗРАБОТИЦЕ)

В статье показано, что неэластичность рынка труда характеризуется рядом показателей. Институциональные различия между странами представляют собой источник неэластичности рынка труда. В разных странах существуют значительные различия в институтах рынка труда в плане законодательства о найме/увольнении, нетипичной занятости, минимальной зарплаты, сроков выплаты и размеров выплат по безработице. Основной вопрос при этом — эволюция институтов рынка труда, чьей деятельностью могут быть объяснены большие различия в рынках труда в ЕС, особенно относительно выплат по безработице.

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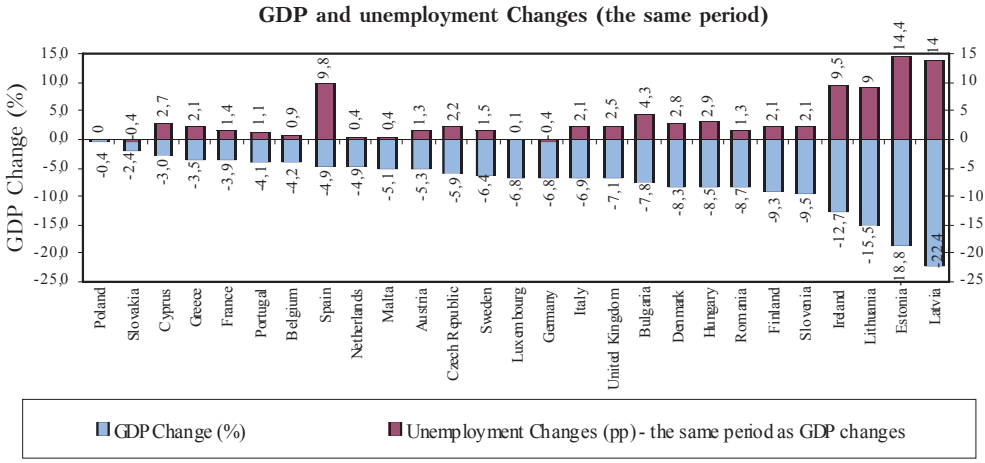
Ключевые слова: *рынок труда, законодательство, безработица, ЕС.*

Introduction. Changes that affected the economies of the world in recent decades due to increased competition generated by globalization and the EU integration, the advance in technology and knowledge economy brought to the forefront of the labour market a new challenge, that of facing rigidities that affect proper functioning and resource allocation. Challenges that labour market, employees and employers will have to face are inequality of access and opportunities at national labour market - that becomes increasingly global, discrimination and marginalization, exclusion and inequalities of all kinds. In this respect, all labour market mechanisms must be in line with economic realities and the need for smart, sustainable and inclusive growth (Europa 2020, European Commission, 2010).

Unemployment is the main indicator of labour market functioning. The idea that labour market rigidities underline the EU unemployment has gained wide acceptance among policy makers (Blanchard, 2006). Rigidities are associated with higher rates of unemployment (Guerrazzi, Meccheri, 2010). Although it was considered that the rigidities / labour market flexibility have not been defined very specifically and directly (Solow, 1998, Pissarides, 1997), the concepts changed and widened due to new conditions which dominate today's world economy (globalization, increased competition, technological advances and the effects on the renewal of skills and crafts etc.).

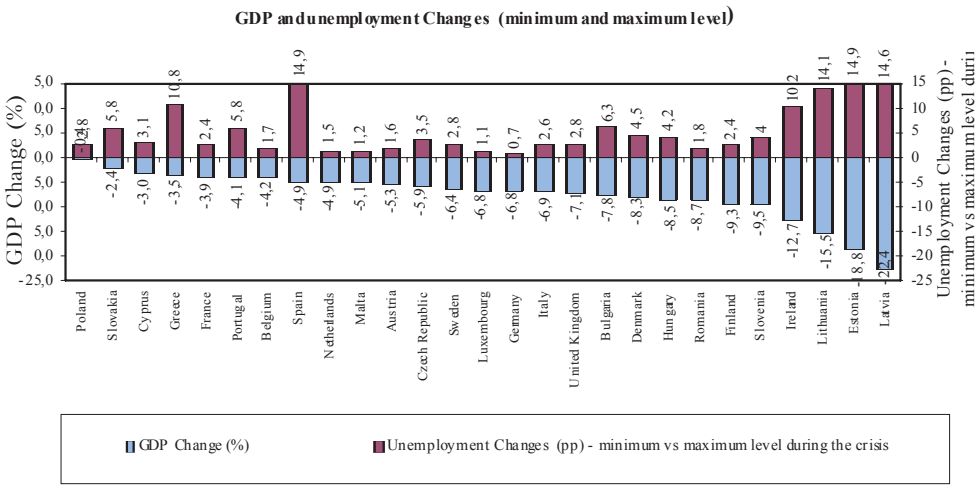
Economic and financial crisis that marked the last years brought to the forefront of scientific economic debate the capacity to absorb shocks and the influence of labour market rigidities in mitigating them or not. For Romania that is preparing to enter the EMU space, issues become more acute since the passing of the monetary policy to the European Central Bank and the exchange rate setting of the euro, need to know to what extent current labour market rigidities can be obstacles to future shock absorption and appropriate measures to reduce them by the increased labour market flexibility.

The shock in demand associated with the financial crisis and expressed by decreasing economic growth inevitably reflected at the labour market, where decreased demand for labour has reduced the number of jobs. Labour markets respond to overall economic activity evolution with changes in employment and unemployment, specific developments showing, generally, higher rates of unemployment in the context of the contraction in economic activity. Figure 1A shows changes in GDP (the difference between the highest level just before the crisis and the lowest level recorded before economic recovery for at least two consecutive months) compared with changes in unemployment (the same period). Germany is the only country where the contraction in economic activity was associated with a decrease in unemployment. The answer is different from country to country, relatively identical shocks in GDP (decreases) resulting in different changes in the evolution of unemployment (increases). For example, Spain and the Netherlands had the same reduction in GDP but very different changes in unemployment. Similarly, countries with smaller decreases in GDP had more significant increases in unemployment (Bulgaria and Romania, for example).



Source: Eurostat Statistics.

Figure 1A. **GDP and unemployment evolution in the EU**



Source: Eurostat Statistics.

Figure 1B. **GDP and unemployment evolution in the EU**

Reducing the output is not reflected in a corresponding increase in unemployment. It is common that the reduction/increase in GDP and employment/unemployment evolves differently, both in size and time (the employment reacts to economic growth with a lag) due to several reasons, some of which are more relevant during crises economic. In such periods, employers can use the opportunity to pass on part-time employees or reduce working hours using other methods, thus avoiding redundancies; such schemes can be encouraged by the government assuming some of the costs of temporary reduction in working hours. In most countries, however, maximum rates of unemployment during the crisis occurred later than the maximum decrease of output. Figure 1B shows the same changes in GDP as Figure 1A shows but compared

to changes in unemployment as difference between the lowest level recorded just before the crisis and the highest level recorded during the crisis. The analysis of the two figures shows that relatively similar reductions in GDP are associated with increases in unemployment with different event time. For example, Greece had much higher unemployment even after economic recovery compared to France. The same situation was in Slovakia compared to Cyprus, in Bulgaria compared to the UK.

The evolution of unemployment is not sufficient to identify the factors of these differences, since employees can work less, for example, which is not captured in the evolution of unemployment rate (Tasci, Zenker, 2011). In addition, some of the causes of these developments are differences in institutions and policies governing labour markets. Labour market rigidities reduce unemployment fluctuations only short-term because workers and employers need a longer period to adapt to economic change. For this reason, countries with flexible labour market institutions and policies had experienced substantial increases in unemployment rates during the economic crisis (US), while countries with relatively rigid institutions and strict labour market policies (France) had experienced smooth increases. However, this performance proves to be better only short-term because studies suggest that flexible labour markets kept unemployment rates at a lower level on the long-term (Tasci and Zenker, 2011). Job-finding and separation rates are influenced by labour market policies and institutions both short and long term through the minimal wage, unemployment benefits, severance payments, labour taxation, employment protection measures etc. The level and duration of unemployment benefits can affect the increasing of long-term unemployment, employment protection measures including strict regulations on layoffs may discourage employers to create new jobs which would then have to maintain even in times of unfavourable economic conditions.

Solow estimated that references at labour market rigidities as source of high unemployment rates should not be limited to nominal and real wage rigidities (Solow, 1998). Therefore, in this paper we analyze labour market rigidities, referring to institutional rigidity in their relationship with unemployment and employment. The attempts to increase flexibility of labour market with low rates of real wage or with labour market deregulation may alleviate unemployment and boost employment in the short term but at the same time can lead to undesirable social effects. It is estimated that labour market deregulation is associated with faster economic growth, increased investment, but also with faster growth of unemployment, reduced consumption and increased social inequities (Bertola, Lo Prete, 2009). The evolution of labour market institutions explain (can explain) different paths/developments at labour markets (Lehmann, Muravyev, 2011).

The generic term “institutions” includes unemployment insurance, restrictions on freedom to hire and fire, excessive regulation of working hours, excessively generous compensation for overtime, extremely strong trade unions to protect workers against competition (Solow 1998). Also included are duration of unemployment benefits and the degree of coordination in collective bargaining (Nickell, 1997). Other authors consider that reduced rate of job creation, different policies and rules (social protection) such as high levels of job security (due to costs involved in hiring or firing, individual firing rules, temporary contracts and reduced working time — employment protection measures), collective bargaining (centralization in collective bargaining —

characteristic of Scandinavian countries) and subsidies (Salvanes, 1997) also generate rigidity. It is underlined in employment protection legislation the minimum wage rigidity as an important factor in the European Union (Malherbet and Cahuc, 2002). The trade union density and labour immobility are also considered as factors of labour market rigidity (Matschke, 2004).

More recent researches focus on the implementation of unemployment benefits and employment protection measures, labour taxation and minimum wage, active labour market policies including better training. They stress that the overwhelming importance in terms of labour market institutions is the understanding how they work (Blanchard, 2006) and not their name and number.

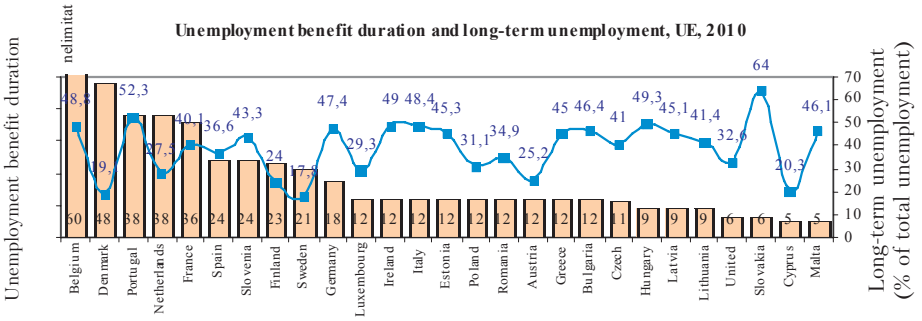
Unemployment benefits. Unemployment benefits protect employees by providing temporary income in case of losing employment, during the search of another job. On the one hand, financial assistance is needed during a job search. On the other hand, it can give workers an incentive to refuse some jobs that otherwise would be find acceptable, thereby reducing the separation rate. Therefore, caeteris paribus, high levels of unemployment benefits can increase the period of unemployment in a country (Tasci, Zenker, 2011) and longer periods can adversely affect long-term unemployment. Low levels of unemployment benefits may increase incentives to search for a new job but can deepen poverty. Given the long-term unemployment and unemployment spells repeatability these payments have become quasi-permanent forms of revenue, reducing incentives to seek employment. To limit the counter-stimulation, facilitating labour market adjustments and ensuring a minimum level of protection, countries need to establish optimal levels of benefits along with stricter eligibility checking measures and participation in active labour market programs as a substitute for benefits liability indefinitely, aiming to return the unemployed back to work (OECD, 2004, 1).

Economic theory emphasizes two effects of unemployment benefits. The first concerns the influence on search intensity, judged in terms of coordination between unemployment and vacancies. The second effect concerns the fact that generous benefits make unemployment less painful and tend to increase negotiated wages. Both effects increase the duration of unemployment and the natural rate of unemployment (Blanchard, 2006).

Generous unemployment benefits are a cause of labour market rigidities and high unemployment rates. Unemployment benefits should be assessed both in terms of income levels compared to income derived from previous work (replacement rate) and the duration of unemployment benefit. Unlike the U.S. that combines high levels of payments with short periods of unemployment benefits, Euro Area Member combines high levels of unemployment insurance with longer periods (Lehmann, Muravyev, 2011). The more generous the more powerful negative effects, the shorter periods of benefits, the unemployment duration tends to decrease (Layard, Nickell, Jackaman, 1991, 2005).

In the European Union the duration of unemployment benefits in 2010 was unlimited in Belgium (but with possible exceptions for very long-term unemployment). Scandinavian countries have long periods of unemployment benefits (Denmark — 48 months). In Romania, the maximum period of unemployment benefit is 12 months and the minimum 6 months for various forms of graduates failing to find work after graduation (Figure 4).

The duration of unemployment benefits must be set to prevent addiction to long-term unemployment benefits. This is especially relevant for older workers and workers with long periods of contributions because they usually tend to extend periods of unemployment (European Commission, 2011). Overall, as seen in Figure 2, providing longer periods of unemployment benefits is not associated necessarily with higher levels of long-term unemployment.



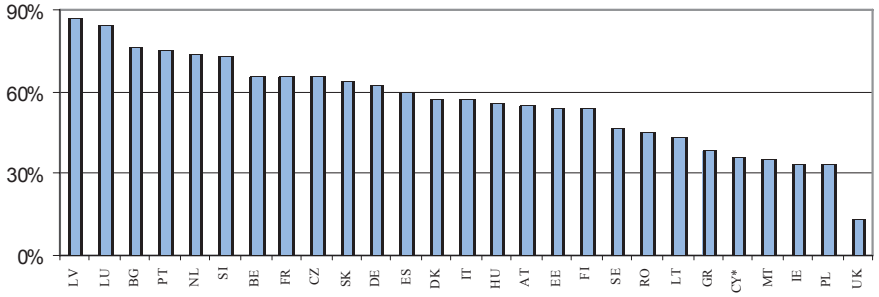
Source: Eurostat Statistics, ICTWSS: Database on Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts.

Figure 2. **Duration of unemployment benefits and long-term unemployment**

The amount of unemployment benefit varies from country to country both in terms of percentage and considered income base. In Romania the unemployment insurance represents 75% of the minimum wage and can increase up to 10% for higher periods of social security contributions. In Belgium, the compensation is up 60% of previous wages, in Denmark it is up to 90% of previous wages minus 8% - social security contributions, in the UK this is a weekly fixed amount based on age, in Bulgaria — 60% of median income of people insured, but can not exceed the minimum wage, in Poland — fixed amount (increased by approximately 30% in 2009) decreasing after the first 3 months to about 21%, Italy — 60% of the average wage in the last 6 months within the first 6 months, 50% within the next 2 months and 40% in the last 4 months, the Netherlands — 75% from the most recent earned income but not more than 177.03 E/day, then percentage decreases to 70%, Germany — 60% of the average income in the last 12 months, with a certain upper limit, in Slovakia — 50% of gross income in the last 3 years, not exceeding 3 times of the average salary (European Commission, LABREF).

Net replacement rate (NRR) is commonly used to characterize the consequences of the transition from unemployment to work in terms of income and, thus, characterized generosity of unemployment benefits. Net replacement rate is usually defined as the ratio of net income during periods of unemployment (unemployment benefits) reported to net income derived from employment. A low rate of replacement is associated with a greater incentive to seek and accept a job for someone who is unemployed. Given that the shortest period of unemployment benefits is 5 months (Malta and Cyprus), for comparability, net replacement rates shown in Figure 3 is related to the second month of unemployment (because net replacement rate in 7th month will be 0 for a country with duration of unemployment benefit less than 7 months) and consider only unemployment benefits without other social benefits. The

country with the highest replacement rate is Latvia (87%) and at the opposite side is the UK (13%). Replacement rate of 45%, representing Romania, can be considered a significant stimulus to search employment since the employment income is more than two times higher that the benefits obtained during periods of unemployment.



Note: NRR for Ciprus refers to 2007.
Source: European Commission, Tax and benefits indicators database.

Figure 3. **Net Replacement Rate, EU, 2010**

Passive employment policies lower job search intensity and motivation of the unemployed to accept certain jobs, thus reducing the economic costs of unemployment, increasing demands on wage levels, leading ultimately to increased rates of unemployment (Fialova, Schneider, 2011).

Conclusion. Labour market institutions are multidimensional, and reducing them to quantitative development is a difficult task. How can we compare, for example, two levels of unemployment benefit, the first offering generous benefits and stricter conditions to obtain benefits, the second lower benefits but providing easy access? Similarly we can compare two systems of employment protection measures, the first including increased protection for certain categories of employees (categories defined by labour market characteristics such as part-time workers or temporary workers or categories defined by social-demographic characteristics: age, region, ethnicity etc.). Atypical employment also needs careful approach because a high level of atypical employment is not necessarily associated with increased flexibility, if the level results from forced acceptance of these types of contracts due to lack of employment alternatives.

In addition, unemployment causes effects not expressed explicitly by statistical data. High rates of unemployment can induce social exclusion and resistance to technological changes, long-term unemployment affects reintegration opportunities due to loss of self-confidence, youth unemployment is associated with loss of skills acquired in schools. Labour market institutions act on these variables. The minimum wage is a way to improve the wellbeing of individuals, it effectively reconciles the economic considerations with those of social nature. Unemployment allowance is intended to provide compensation between, on the one hand, the duration and generosity of payments and, on the other hand, the need for financial assistance during the job search in a way that does not adversely affect job search intensity and employment desire.

Labour market rigidities have multiple preconditions, not only institutional. Other issues are particularly important and require parallel approaches. In a next step we address the wage rigidities (nominal and real) seeking to highlight their impact on macroeconomic variables in a model adapted to this purpose.

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