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THE QUALITY OF ECONOMIC POLICY AND THE LABOUR MARKET IN POLAND, THE US AND THE EU

Abstract

The theory of economics and empirical research emphasise the relevance of institutions and the quality of their activity to the economic processes taking place in individual economies. One of the measures used for formal institutions is the *Index of Economic Freedom*. The index is a simple average of 10 individual freedoms, each personal and national prosperity and can be used to evaluate the quality of economic policy.

The level of economic freedom determines to a large extent the country's competitive performance. Competitiveness is a complex concept, evaluated by different institutions using different indicators which reflect only selected aspects of this phenomenon. In 1997 the European Commission proposed the so-called "competitiveness pyramid", presents the factors determining competitiveness of an economy. Competitiveness of an economy is thus dependent on its condition resulting from the economic policy implemented by the country, its major determinants being the factors related to the labour market and its changes. A higher quality of economic policy should imply improvement in the economy's competitiveness, described by relevant indicators, with emphasis on the description of the labour market. The major objective of the paper is therefore to analyse the relationship between the quality of economic policy, described by the index of economic freedom, and the situation in the labour market.

Key words: economic freedom, economic policy, labour market.

Introduction

The quality of the economic policy pursued in a country determines the economic performance of both individual market players and the entire economy. At the moment, the theory of economics and empirical research emphasise more and more often the relevance of institutions and the quality of their activity to the economic processes taking place in individual economies. The empirical evidence is based on a multitude of indicators measuring the quality of formal or informal institutions (see: Brzozowski, Gierałtowski, Milczarek, Siwińska-Gorzelak, 2006). One of the measures used for formal institutions, and encompassing subjective rankings of the efficiency of property rights and the level of bureaucracy, which informs whether it is relatively easy to run a business and provides approximate transaction costs, is the *Index of Economic Freedom*, developed by the Heritage Foundation. This indicator evaluates selected aspects of market efficiency within economic liberty, its underlying criteria being: business freedom, the country's trade policy, tax burdens and budget policy, the extent of the state's interventions in the economy, price and monetary policy, investment freedom, banking and finance, salaries and labour market policy, rights of property ownership and corruption level, black market[1]. As we can see, within the index of economic freedom, various aspects of the quality of economic policy pursued in individual countries are evalu-

[1] For more see: www.heritage.org

ated. In other words, the index can be used to evaluate the quality of economic policy.
The level of economic freedom determines to a large extent the country's competitive performance. Competitiveness of an economy is generally perceived as a figure describing the importance of a given economy to the global market. It is a complex concept, evaluated by different institutions using different indicators which reflect only selected aspects of this phenomenon.

In order to transform the EU's economy into the world's most competitive, dynamic and knowledge-based one till the year 2010, the *Lisbon Strategy*, i.e. a multi-year reform and structural changes programme was developed and implemented in March 2000. Each EU member state is obliged to follow the strategy and the progress in its implementation is evaluated by the European Commission. The latter uses a wide range of measures to evaluate the progress made by member states in implementing the *Lisbon Strategy*, and hence their competitive performance. Those indicators encompass a number of aspects related to competitive performance, originating in the so-called "competitiveness pyramid" proposed by the European Commission in 1997 (Hildebrandt, 2002, p. 69). Basing on this concept, a multitude of macro- and micro-level competitiveness models have been developed, and the concept itself presents the factors determining competitiveness of an economy. At the top, there is the most important one – the standard of living, a synthetic indicator of an economy's competitive performance, measured with GDP *per capita*. This factor is determined by two others: the employment rate and productivity, which in turn are composites of further detailed components. Employment rate is affected by: activity rate, job creation, labour market efficiency, demographic aspects and intangible investment understood as investment in human resources (raising their skills). Productivity in turn is determined mainly by: innovative performance, R&D expenditure, investment in capital assets and financial conditions in the economy (sources of financing for investment, taxes). Competitiveness of an economy is thus dependent on its condition resulting from the economic policy implemented by the country, its major determinants being the factors related to the labour market and its changes.

A higher quality of economic policy should imply improvement in the economy's competitiveness, described by relevant indicators, with emphasis on the description of the labour market. The major objective of the paper is therefore to analyse the relationship between the quality of economic policy, described by the index of economic freedom, and the situation in the labour market. First, however, the tendencies in the level of economic freedom and selected structural indicators describing the labour market and used to evaluate the implementation of the *Lisbon Strategy* have been presented. The analyses, encompassing the years 2000-2008, have been carried out for Poland, EU member states and the US, the latter used for reference. Taking into consideration the fact that the ranking of economies in terms of their economic freedom is published annually around the middle of the year, it should be recognised that the evaluation refers actually to the turn of two years (the analysed and the preceding). The analysis of interrelations between the quality of economic policy, described with the index of economic freedom, and the situation in the labour market will therefore be carried out assuming a one-year delay.

Economic freedom – dimensions and extent

The index of economic freedom, calculated and published in the Heritage Foundation report and the Wall Street Journal, is one of the indicators evaluating the quality of institutions and economic policy implemented by a state. This index was employed for the first time in 1995 to evaluate the performance of 101 countries and concerned nine aspects of economic freedom. The labour freedom was not evaluated as a separate issue until 2005. However, labour policy has been a key variable in the Index of Economic Freedom since its inception as part of the wages and prices factor as well as the regulation factor. Since 2005, the evaluation has involved ten dimensions of economic freedom graded individually for each country using a 0% to 100 % scale (80%-100% free, 70%-79,9% mostly free, 60%-69,9% moderately free, 50%-59,9% mostly unfree, 0%-49,9% repressed), and the position of a country in the global ranking is found as an average of all those dimensions, which include (2008 Index of Economic Freedom, 2008, p. 40-41 and 53):

- Business Freedom is the ability to create, operate, and close an enterprise quickly andeasily. Burdensome, redundant regulatory rules are the most harmful barriers to business freedom.
- Trade Freedom is a composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services.
- Fiscal Freedom is a measure of the burden of government from the revenue side. It includes both the tax burden in terms of the top tax rate on income (individual and corporate separately) and the overall amount of tax revenue as a portion of gross domestic product (GDP).
- Government Size is defined to include all government expenditures, including consumption and transfers. Ideally, the state will provide only true public goods, with an absolute minimum of expenditure.
- Monetary Freedom combines a measure of price stability with an assessment of price controls. Both inflation and price controls distort market activity. Price stability without microeconomic intervention is the ideal state for the free market.
- Investment Freedom is an assessment of the free flow of capital, especially foreign capital.
- Financial Freedom is a measure of banking security as well as independence from government control. State ownership of banks and other financial institutions such as insurer and capital markets is an inefficient burden, and political favoritism has no place in a free capital market.
- Property Rights is an assessment of the ability of individuals to accumulate private property, secured by clear laws that are fully enforced by the state.
- Freedom from Corruption is based on quantitative data that assess the perception of corruption in the business environment, including levels of governmental legal, judicial, and administrative corruption.
- Labour Freedom is a composite measure of the ability of workers and businesses to interact without restriction by the state. The labor freedom factor is a quantitative factor based on objective data from the World Bank's *Doing Business* study (http://www.doingbusiness.org/documents). It provides reliable cross-country data on regulations concerning minimum wages, laws inhibiting layoffs, severance requirements, and measurable regulatory burdens on hiring, hours, and so on.

Economic freedom is that part of freedom that is concerned with the material autonomy of the individual in relation to the state and other organized groups. An individual is economically free who can fully control his or her labour and property (2008 Index of Economic Freedom, 2008, p. 39).

Table 1 presents the indices of economic freedom for Poland, EU-25 and EU-27, the Eurozone, EU-15, and the US for the period 2000-2008. The index of economic freedom for the EU in various variants was calculated as an arithmetic mean of indices for individual countries. A higher level of the index reflects higher economic freedom in a country or group of countries.

Table 1. Index of economic freedom (as %)

Year	Poland	EU-27	EU-25	EU-15	Eurozone	US
2008	59.5	70.3	71.0	72.7	73.2	80.6
2007	57.4	69.0	69.6	71.0	71.5	80.9
2006	59.6	68.9	69.5	70.8	70.9	81.1
2005	58.6	67.6	68.5	69.8	69.9	79.7
2004	58.7	67.7	68.7	70.1	70.3	78.7
2003	61.8	67.4	68.5	70.1	70.4	78.2
2002	65.0	67.2	68.3	69.9	70.1	78.4
2001	61.8	66.6	67.9	69.1	69.1	79.1
2000	60.0	64.2	65.3	67.1	67.0	76.4

Source: own study and www.heritage.org/index as of 20.10.2008.

The level of economic freedom in 2000 in Poland, placed our country in the 75th place among 161 countries examined in total, and in the 21st in EU-25 and EU-27. The US were ranked as 8th. The highest rank ever in terms of economic freedom was reported for Poland in 2002, when the country was placed as 57th in the world, 17th among the EU-27 countries and 13th as compared and contrasted to the EU-15 member states. Poland's performance was better than that reported for Italy and France belonging to the Eurozone. In the analysed period, the index of economic freedom in Poland was declining gradually till the year 2006, when the country was ranked as 84th in the world, the last among the EU-25 and the next to last among the EU-27 member states. Over the last two years, a slight improvement in the level of this index was observed. In the 2008 ranking of economic freedom, when 162 countries in total were evaluated, the US were in the 5th place, and Poland – in the 83rd, thus noting an improvement of four places. Still, it was the worst position in EU-27. The major Polish weaknesses were identified as the following: high corruption level, excessive interventionism in the economy, limited business freedom, rigid labour law. Traditionally, like in previous years, trade and monetary policies were found to be Poland's major strengths.

The indices of economic freedom for the examined countries and groups of countries, presented in Table 1, indicate that in the analysed period the highest degree of economic freedom was enjoyed by organisations in the US – an economy believed to be one of the most competitive in the world. The US index of economic freedom was approx. 7-11 and even over 16 percentage points higher than in the EU and Poland, respectively.

A still greater difference between the US on the one hand, and the EU and Poland on the other, can be observed within the labour freedom. The levels of indices of labour freedom in the analysed countries and groups countries have been presented in Table 2.

Table 2. Index of labour freedom (%)

Year	Poland	EU-27	EU-25	EU-15	Eurozone	US
2008	53.5	60.9	60.4	59.7	59.3	92.3
2007	54.3	54.7	53.9	58.7	57.0	92.0
2006	53.8	62.8	62.3	64.3	63.7	96.7
2005	52.5	57.2	56.6	55.4	53.1	93.1

Source: www.heritage.org/index as of 20.10.2008 and own study.

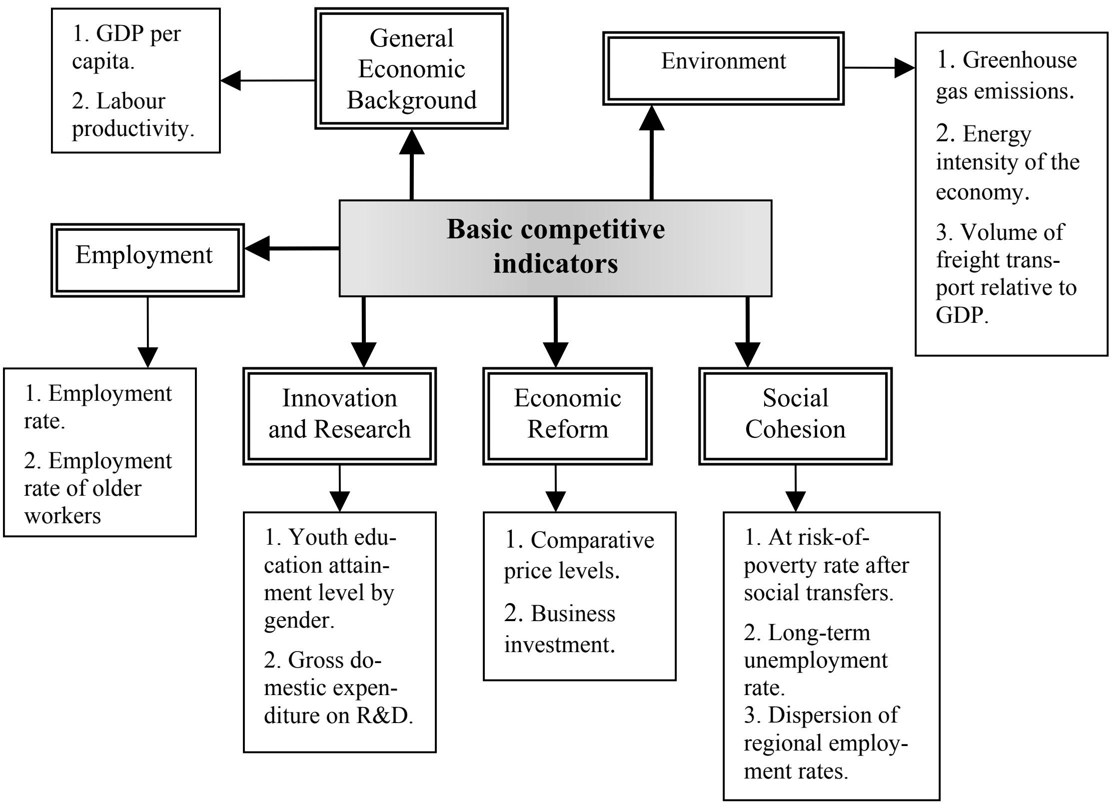
The US labour market for the years 2005-2008 was recognised as free. The indices of labour freedom for the EU member states represented approximately 50% of the figures for the US market in each year of the analysed period, revealing a higher degree of regulation in the European market, hence the aggregate EU labour market should be evaluated as moderately free or mostly unfree. The labour market in Poland, on the other hand, where the indices of freedom did not exceed 55% over the whole analysed period, was classified as mostly unfree.

Two of the above-discussed indicators of economic freedom, i.e. index of economic freedom and index of labour freedom, have been used in the next part of the paper as independent variables describing the situation in labour markets of the analysed countries and groups of countries.

Characteristics of the labour market in Poland, the US and the EU

Structural indicators are important tools used to evaluate the progress the EU countries have made in the implementation of the *Lisbon Strategy*, and indirectly – the competitiveness of the economy. The 78 indicators used in the analysis have been grouped into five categories: General Economic Background, Employment, Innovation and Research, Economic Reform, Social Cohesion and Environment. In 2005, the European Commission decided to adopt a list of 14 basic structural indicators and grouped them in the above-mentioned categories. This list has been presented in Fig. 1.

Fig. 1. Basic competitive indicators describing an economy



Source: own study.

As many as five among them describe the situation of the labour market:

1. Labour productivity.
2. Employment rate.
3. Employment rate of older workers.
4. Long-term unemployment rate.
5. Dispersion of regional employment rates.

The labour productivity index is one of two basic measures describing general condition of the economy (next to GDP per capita). The last two of the above-listed measures are social cohesion indices. All the others belong to employment indicators.

Tables 3-7 present the analysed structural indicators for Poland and the US as compared and contrasted to the enlarged EU, the Eurozone, and the "old" 15 EU member states. Although all the five indicators have been considered by the European Commission as the basic indicators in the evaluation of progress in implementing the *Lisbon Strategy* and their levels are all affected by economic policy, only two of them will be used in further analyses as variables dependent on the quality of that policy.

Table 3. Labour productivity index (as % of the EU-27 level)

Year	Poland	EU-27	EU-25	EU-15	Eurozone	US
2007	67.2	100.0	104.8	110.2	109.9	142.3
2006	66.1	100.0	104.6	110.4	110.0	142.4
2005	65.1	100.0	104.5	110.7	110.3	142.9
2004	64.9	100.0	104.4	110.9	110.0	140.5
2003	62.4	100.0	104.2	111.4	111.0	139.3
2002	53.9	100.0	104.0	111.9	111.7	137.6
2001	52.1	100.0	103.8	112.5	112.6	137.8
2000	50.8	100.0	103.7	113.2	113.4	139.8

Source: http//epp.eurostat.ec.europa.eu/tgm as of 21.10.2008.

The labour productivity index compares and contrasts labour productivity in a country or group of countries to the average productivity in the EU-27. Despite improvement in the figure observed in Poland over the analysed period, our labour market should still be evaluated as the least productive among the economies examined. At the same time, however, the employed population in the EU has significantly lower productivity than its peers in the US. This difference in the levels of productivity is still comparable to the difference between the average productivity of the employed in Poland and the EU.

The employment rate is calculated by dividing the number of persons aged 15 to 64 in employment by the total population of the same age group. The indicator is based on the EU Labour Force Survey. The survey covers the entire population living in private households and excludes those in collective households such as boarding houses, halls of residence and hospitals. Employed population consists of those persons who during the reference week did any work for pay or profit for at least one hour, or were not working but had jobs from which they were temporarily absent.

Employment level is one of two basic determinants of competitiveness of economies identified in the "competitiveness pyramid", being at the same time the most concise indicator describing the labour market, revealing the level of involvement of the population in the labour process, and for this reason is has become the major interest of further analysis. In the whole analysed period, the highest level of employment rate was reported for the US economy, and the lowest – for Poland. In our country, this indicator is significantly lower than in the other EU member states (a 8-13 and a 6-12 percentage point difference for EU-15 and

EU-27, respectively), and unlike in those countries, it showed a downward tendency in the first four year of analysis: the level of this indicator decreased from 55.0% in 2000 to 51.2% in 2003.

Table 4. Employment rate (%)

Year	Poland	EU-27	EU-25	EU-15	Eurozone	US
2007	57.0	65.4	65.8	67.0	65.7	71.7
2006	54.5	64.5	64.9	66.2	64.8	71.9
2005	52.8	63.6	64.0	65.4	63.8	71.5
2004	51.7	63.0	63.4	64.8	63.2	71.2
2003	51.2	62.6	63.0	64.5	62.7	71.2
2002	51.5	62.2	62.8	64.2	62.4	71.9
2001	53.4	61.8	62.8	64.1	62.2	73.1
2000	55.0	61.2	62.4	63.4	61.7	74.0

Source: http//epp.eurostat.ec.europa.eu/tgm as of 21.10.2008.

In 2003, the worst year for Poland in the whole analysed period, the employment level in EU-15 was much higher, reaching the level of 64.2%. Also the average indicator for the then candidate countries (EU-10) was higher (55.9%) than the figure for Poland. In the year 2004, following gradual improvement of the general condition of the economy observed in two preceding years, an upward tendency began, and the indicator reached the level of 57% reported in 2007. Despite all those positive changes, Poland still remains the country characterised by one of the lowest employment levels among all 27 EU member states. Over the whole analysed period, employment rate for Poland remained below all the averages – for EU-27, EU-25, EU-15, and the Eurozone – and much below the target set by the *Lisbon Strategy*, i.e. 70% to be achieved by the year 2010. Even though the average employment level in the EU countries is also lower than the target set by the *Strategy*, Polish economy still has more to catch up in the next few years. The process of improvement will not be an easy one since the activity rate is much lower than the figure in the other EU member states.

At the same time, as emphasised in the next reports on the condition of Polish economy, a much lower level of this indicator as compared and contrasted to other EU countries, is related to a passive labour market policy implemented in the 1990s. As a result people who had a chance for coming back to work, withdrew from professional life. The major problem reported in the Polish labour market is low activity and low employment, related to the effects of the plummeting number of people employed after 1999 (Polska 2006. Raport o stanie gospodarki, 2006, p. 141; Polska 2007. Raport o stanie gospodarki, 2007, p. 87 and Polska 2008. Raport o stanie gospodarki, 2008, p. 71).

The employment rate of older workers is calculated by dividing the number of persons aged 55 to 64 in employment by the total population of the same age group. The indicator is based on the EU Labour Force Survey. The survey covers the entire population living in private households and excludes those in collective households such as boarding houses, halls of residence and hospitals. Employed population consists of those persons who during the reference week did any work for pay or profit for at least one hour, or were not working but had jobs from which they were temporarily absent.

The data presented in Table 5 reveal that over the last years the US economy has employed around 60% of population aged 55-64, whereas in the EU this share amounts to 45-47% on average. The level of employment rate among older people places our country at the inglorious top of the analysed economies. This low level of this rate in Poland is an effect of both a low level of human capital among older people but also the incapability of the labour market policy which should be related to protecting this group of population instead. A special programme has been developed to encourage professional activity of older people in our economy, *Solidarity of generations. Activities promoting professional activity of people aged 50+*, and passed by the Cabinet on the 17[th] of October 2008. The programme includes the activities undertaken by the government to encourage employment of people aged 50+, including in particular the incentives for enterprises which employ people in this age group, as well as activities supporting improvement in qualifications, abilities and labour productivity among employees of this age group. The aim is to increase the employment rate among people aged 50+ to 50% of the total population of this age by the year 2020, following the objectives set in the Lisbon Strategy. Nevertheless, since the programme has been implemented not too long ago, its effects cannot be analysed yet.

Table 5. Employment rate of older workers (%)

Year	Poland	EU-27	EU-25	EU-15	Eurozone	US
2007	29.7	44.7	44.9	46.5	43.3	61.8
2006	28.1	43.5	43.7	45.3	41.8	61.7
2005	27.2	42.3	42.6	44.2	40.6	60.8
2004	26.2	40.7	41.0	42.5	38.7	59.9
2003	26.9	40.0	40.3	41.7	37.9	59.8
2002	26.1	38.5	38.7	40.2	36.5	59.4
2001	27.4	37.7	37.5	38.8	35.2	58.5
2000	28.4	36.9	36.6	37.8	34.2	57.7

Source: http//epp.eurostat.ec.europa.eu/tgm as of 21.10.2008.

Older people comprise a group whose economic activity in our economy is particularly low (activity rate for this group amounted in 2007 to 39.1%) (Polska 2008. Raport o stanie gospodarki, 2008, p. 75). They usually remain unemployed for more than 12 months, accounting for the significant part of the long-term unemployment rate, presented for the analysed period in Table 6.

Table 6. Long-term unemployment rate (%)

Year	Poland	EU-27	EU-25	EU-15	Eurozone	US
2007	4.9	3.1	3.0	2.8	3.2	0.5
2006	7.8	3.7	3.7	3.2	3.8	0.5
2005	10.3	4.1	4.0	3.4	3.9	0.6
2004	10.3	4.2	4.1	3.4	4.0	0.7
2003	11.0	4.1	4.0	3.3	3.9	0.5
2002	10.9	4.0	3.9	3.1	3.6	0.3
2001	9.2	3.9	3.8	3.1	3.6	0.2
2000	7.4	4.0	3.9	3.4	3.9	0.3

Source: http//epp.eurostat.ec.europa.eu/tgm as of 21.10.2008.

Long-term unemployed (12 months and more) persons are those aged at least 15 years not living in collective households who are without work within the next two weeks, are available to start work within the next two weeks and who are seeking work (have actively sought employment at some time during the previous four weeks or are not seeking a job because they have already found a job to start later). The total active population (labour force) is the total number of the employed and unemployed population. The duration of unemployment is defined as the duration of a search for a job or as the length of the period since the last job was held (if this period is shorter than the duration of the search for a job).

In every year of the analysed period, long-term unemployment rate in Poland oscillated around 50% of the total unemployment rate, which means that a half of the population registered in Poland as unemployed remained without work for more than 12 months. A similar situation was observed in the EU countries where the average long-term unemployment rate accounted for nearly 50% of the total unemployment rate registered, yet it was 0.5-2.5 times lower than in Poland. Nevertheless, as compared to the US long-term unemployment rate, the European economies, including Poland, have a lot to catch up. The long-term unemployment rate in the US accounted for as little as 10% of the total unemployment, i.e. it was relatively five times lower than in the European countries.

Dispersion of regional employment rates is the next structural indicator describing the labour market. Changes in that figure over the analysed period have been shown in Table 7.

Table 7. Dispersion of regional employment rates

Years	Poland	EU-27	EU-15	Eurozone
2007	4.5	11.1	10.5	10.8
2006	5.1	11.4	10.5	10.6
2005	5.6	11.9	10.8	10.6
2004	6.4	12.1	11.0	10.5
2003	7.2	12.9	11.8	11.5
2002	7.3	13.2	12.4	12.1
2001	7.2	13.2	13.1	12.7
2000	6.9	13.0	13.3	13.0

Source: http//epp.eurostat.ec.europa.eu/tgm as of 21.10.2008.

The dispersion of regional (NUTS level 2) employment rates of the age group 15-64 shows the regional differences in employment within countries and groups of countries (EU-27, EU-15, euro area). The dispersion of regional employment rates is zero when the employment rates in all regions are identical, and it will rise if there is an increase in the differences between employment rates among regions.

The structural indicator under discussion is not estimated for all the countries since not all the EU member states (and also non-EU countries) NUTS 2 regions are identified thus disabling comparability of dispersion of regional employment rates within the same cross-section of data which has been applied in this study (e.g. unavailability of data for the USA). The data available allow reaching a conclusion that it is only in terms of the regional dispersion of employment that Polish economy can be perceived positively as compared to other EU countries. This rate for Poland in the analysed period was on average 50% lower than the EU average. It can be traced back mainly to the structural features of the labour force in our country, which is reflected in the low mobility of those resources within the country. If we examine the dispersion of regional employment rates, we can observe that it is much higher in Poland than the EU-average. Poles are a relatively less mobile labour force but over the last years it has turned out that if they do decide to search a job in another region, it is usually one in another country – the degree of external spatial mobility has increased.

Although on a short run the emigration of Poles has had positive effects (such as decline in the unemployment rate, inflow of capital to the country), on the long run it may have a negative impact (e.g. risk of shortage of the human capital in our country, worse demographic structure of the society and reduction of the supply of labour).

The impact of the quality of economic policy on the situation in the labour market

The quality of economic policy is determined to a large extent by the quality of formal institutions shaping it. For this reason, it has been accepted in the paper that the quality of economic policy improves with the quality of formal institutions active in the economy. The indicator of quality of formal institutions used in the paper – *The Index of Economic Freedom* – allows depicting the quality of economic policy in its different aspects. The components of this index, reflecting the economic policy in its many aspects, usually refer directly or indirectly to the labour market, pointing to the extent of its regulation or conditions in a given period in a country. In the next part of the paper, the index of economic freedom will be considered as an independent variable which has an indirect impact on the condition of the labour market. The second independent variable used in the analysis is the Labour Freedom indicator, an element of the index of economic freedom, which reflects the quality of economic policy directly related to the labour market.

The situation in the labour market is determined by both individual characteristics of the people comprising the labour force in an economy and the economic policy related to that market. Improvement in the quality of the present economic policy should therefore be reflected in the improvement in the situation in the labour market. Among the structural indicators analysed in the preceding part of the paper, it is the employment rate and long-term unemployment rate that describe the situation in the labour markets of the analysed countries and groups of countries in the most concise way. This is the reason why the two indicators have been used in the next part of the analysis as variables dependent on the quality of economic policy.

The impact of quality of economic policy on the labour market has been analysed separately for two identified independent variables. Since the time series of the available data representing independent variables were not of equal lengths, two methods of analysis have been employed.

Table 8 presents the values of the linear correlation coefficients for *Index of Economic Freedom* and dependent variables: the employment rate and the long-term unemployment rate.

Table 8. The linear correlation coefficients for *Index of Economic Freedom* and dependent variables

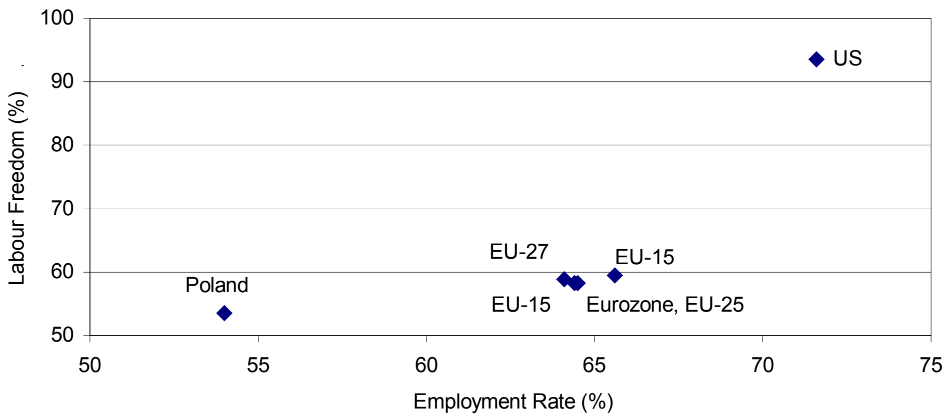
Variable	Poland	EU-27	EU-25	EU-15	Eurozone	US
Employment rate	-0.59091	-0.44996	0.74222	0.81323	0.78726	-0.50319
Long-term unemployed rate	0.58577	-0.48494	-0.38839	-0.48252	-0.39992	0.35681

Source: own study.

The data reveal the differences in the directions and strengths of the relationships between the analysed variables. In Poland, the USA, and the EU-27 countries, there is an inverse relationship between the quality of economic policy and employment rate. It follows that the broader extent of freedom represented by a higher *Index of Economic Freedom* was related in the analysed period to a reduction in the employment rate but the force of this correlation was average. In the EU-25, EU-15 and the Eurozone countries, on the other hand, the improvement in the quality of economic policy was related in the analysed period to a growth in the employment rate, and the value of the correlation coefficient suggests this correlation is significant. Moreover, we can also notice a drop in the force of the positive correlation given that we include in our calculations the 10 new member states which joined the EU in 2004 (EU-25 as compared to EU-15), and later after the next enlargement. The quality of economic policy in Poland and the US was directly related to long-term unemployment, whereas in the EU that correlation had the opposite direction. It means that the rise in the index of economic freedom was accompanied in Poland and the US by an increase in the long-term unemployment, whereas in the EU – by its drop. Only for Poland, however, the relationship was strong. All those observations suggest that the extent of economic freedom not always initiates expected positive changes and hence not all the countries enjoy the same benefits related to the labour market and resulting from broader extent of economic freedom, which reflects the indirect impact of the quality of economic policy.

The second independent variable adapted – labour freedom – was estimated as a separate element of the *Index of Economic Freedom* only in the years 2005-2008. This period is too short to provide reliable results of employing statistical and econometric methods to the analysis of direct relationships between the quality of the labour market policy and he situation in that market. For this reason, a graphic presentation of those relationships has been chosen and the results have been presented in Figures 2 and 3.

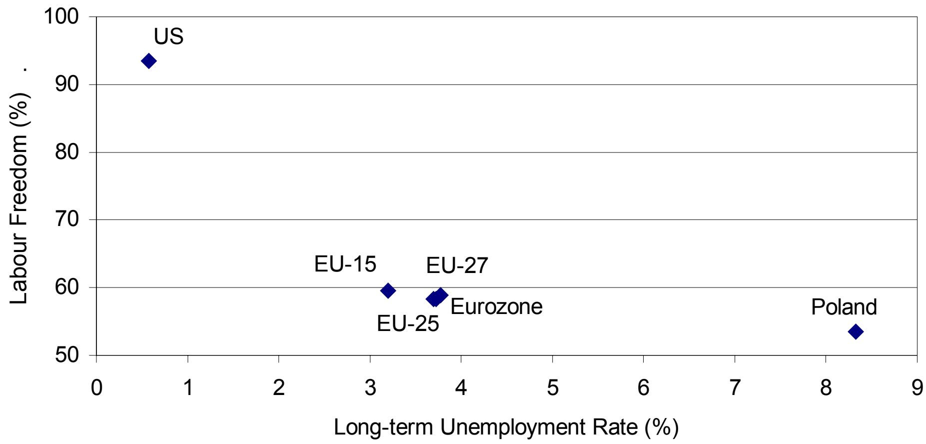
Fig. 2. Relationship between the quality of labour market policy and employment rate in the years 2005-2008



Source: own study

The positive correlation between the quality of labour market policy and employment, which can be observed in Fig. 2, indicates that lower degree of regulation of the labour market related to its higher flexibility had a positive impact on the degree of economic activity of entities, and the better the quality of the labour market policy, the higher the employment level, even though the ratios of the employment rate to the labour freedom are lower in the US than in the EU member states. It may imply that a slight further improvement in the quality of the labour market policy in the EU should assure achievement of the target employment rate defined by the Lisbon Strategy.

Fig. 3. The relationship between the quality of labour market policy and long-term unemployment rate in the years 2005-2008



Source: own study

Positive effects of a better quality of the labour market policy can be observed also in Fig. 3. It shows a negative correlation between labour freedom and long-term unemployment rate in individual countries and selected groups of EU countries, which implies that long-term unemployment declines with less regulation of the labour market and improvement in its flexibility.

Conclusion

The conditions in real labour markets in individual economies differ significantly from the theoretical model of a perfectly competitive labour market where employment is determined by the level of salaries and estimated with a market mechanism at a level of optimal employment whereas unemployment is only voluntary.

Labour markets in contemporary economies are not perfectly competitive; they are regulated to a lesser or greater degree. The conditions of their operation are usually strongly related to the extent and quality of economic policy pursued in the country, reflecting the quality of the existing system of institutions. One of the most significant functions of those institutions is to provide the entities with a supportive environment for operation and cooperation in the conflicted world. Improvement in the quality of activity of the existing institutions should contribute to better solution of conflicts or at least to their mitigation, and to an improvement in the condition of the entire economy, including the labour market, e.g. through reduction of institutional unemployment present in every economy (Jarmołowicz, Woźniak, 2006, p. 52).

Economic policy related directly to the labour market has a direct impact on its functioning. The experience of a number of countries shows that less regulation in the labour market and better flexibility to its reaction to the changes in economic environment contribute to: better allocation of the labour force, improvement in the general condition of the labour market, higher employment and lower unemployment. The results obtained in the analysis provide evidence supporting the thesis that better quality of economic policy concerning directly the labour market, and reflected in a higher labour freedom index, was related in the analysed period with higher employment and lower long-term unemployment in the countries and groups of countries examined.

The analysis reveals also the relationship between the quality of economic policy which is not directly and solely focused on the labour market itself (e.g. trade, investment or monetary policies) with the condition of that market. Improvement in the quality of this policy was in the analysed period strongly related to a higher rate of employment in the groups of countries examined (except for the EU-27) but for two of the analysed economies, Polish and the US, this relationship was inverse and weaker. It implies that economic policy adopted in Poland and the US, whose quality underwent changes in the analysed period, did not initiate the expected positive effects reflected in the level of employment. On the other hand, the changes in the quality of that policy observed in those countries were positively correlated with their levels of long-term unemployment.

In the analysed groups of countries, an upward tendency observed for the quality of economic policy was inversely related to the changes in the unemployment rate. Nevertheless, this correlation, expressed with the linear correlation coefficient, was weak, which suggests that there were other factors apart from those included in the independent variable (*Index of Economic Freedom*) that had more impact on the long-term unemployment rate in the analysed period and countries. Identification and analysis of those factors may become a subject matter of a separate study.

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