

PART I

LABOUR MARKET INSTITUTIONS IN CHOSEN EUROPEAN COUNTRIES

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LABOUR MARKET INSTITUTIONS IN THE TRANSITION COUNTRIES OF EUROPE AND THEIR INFLUENCE ON LABOUR MARKET PERFORMANCE

Abstract

This paper contains attempt to estimate influence of labour market institutions on labour market performance in transition countries in Europe. The most important argument is that although labour market institutions are important in controlling the level and structure of unemployment, the decisive factors are rather macroeconomic. The analysed transition countries seem to possess a set of labour market institutions, which is broadly similar to that of the Western Europe (the “old” EU). Therefore it can be also argued, that adding the nine transition countries to the OECD did not increase diversity of this institution in a dramatic way, as the analysed transition countries opted (as a rule) for average institutional package.

According to results of this research, there seems to be no link between the levels of strictness of Employment Protection Law (EPL) and overall level of unemployment, but active labour policies facilitate re-entry into the labour market. Therefore, I draw final conclusion that although labour market institutions are important in controlling the level and structure of unemployment, the decisive factors are, however, definitely of macroeconomic nature. Those decisive factors are in the realm of the general condition of economy: the size of aggregate demand and conditions on foreign markets.

Methodology used in this paper is based on the classical European tradition of social theorising. According to Preston (1998): “the classical European tradition of social theorising is concerned with the political economic, social institutional and culture analysis of broad patterns of complex change”.

Key words: Labour Economics Policies, Comparative Studies of Countries, Socialist Institutions and Their Transitions, Labour Productivity, Unemployment.

Introduction

In this paper I will make an attempt to estimate influence of labour market institutions, such as employment protection legislation (EPL), wage setting systems, unemployment benefit systems, labour market policies and taxes on labour on labour market performance measured by such traits as number of unemployed, unemployment rates and structure (mostly by sex, age, and the length of unemployment period) in selected European countries. I will concentrate on so-called transition countries in Europe, namely new members of the EU: those that joined EU in May 2004,¹ those that will join the EU in January 2007² and Croatia, the most likely next member of the European Union. Other former “communist” states of Europe will be analysed only briefly, as some, like former East Germany (GDR) joined the Union much earlier, and by the way of “Anschluss”, i.e. being *de facto* taken over by the (then) existing member of the EU (in this case West Germany or FRG), and because the other countries, which are, by the way, not considered presently (year 2006) as serious candidates for the full EU membership, are either countries with serious internal political problems, frequently even unable to control its whole territory³ or are in such deep economic troubles that for practical reasons make their EU membership impossible in the foreseeable future⁴ or are simply too big for the EU (Russia), or only formally having part of their territory in Europe (Kazakhstan). As to Belarus (Belorussia): because of its strong links to Russia, it can be, for the purpose of this paper, treated as a *de facto* associated member of the Russian Federation.

I will argue, that although labour market institutions are important in controlling the level and structure of unemployment, the decisive factors are rather macroeconomic, i.e. the general condition of economy, especially the size of aggregate demand and conditions on foreign markets, that *on the one hand* influence (frequently in a positive way) demand for the exports, but *on the other hand* can reduce domestic employment by encouraging imports of good and services that replace goods and services produced internally, as it can be observed especially in case of Poland, where years of restrictive monetary policies and policy of overvalued currency are the major factors explaining exceptionally high level of unemployment in this country.⁵

¹ Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.

² Bulgaria and Rumania.

³ They are Bosnia-Herzegovina, Georgia, Moldova (Moldavia) and Serbia. Thus it can be argued, that they are not “proper” states, and because of this cannot be compared to the “real” states, i.e. those, who are able to control all of its territory.

⁴ They are Albania, Georgia, Macedonia, Ukraine and generally the majority of former Soviet Republics, especially Armenia.

⁵ It should be noted that current level of unemployment in Poland is significantly lower than even a year ago, but this reduction can be attributed mostly to increased level of emigration, not any real improvement in fundamentals of Polish economy: according to <http://www.polishmarket.com/index.php?item=5> (as on 7/12/2006) rate of unemployment in Poland decreased from very high 19.0% in 2004 to a little bit more acceptable 15.6% at the end of 2006, but at the same time population of Poland decreased (according to official data) from 38,174 thousand in 2004 to 38,044 thousand at the end of 2006. It is estimated that after 1989 (i.e. last year of communist rule in Poland) at least a million of Poles left Poland, mostly to Western Europe and the US, in search for employment and generally a better life (see, for example, <http://serwisy.gazeta.pl/kraj/1.75055.3622148.html> as on 7/12/2006). According to European Association for Comparative Economic Studies (<http://eaces.gelso.unimn.it/eaces/eaces.htm> as on 7/12/2006) up to 1 million 120 thousand Poles left Poland to „old” EU since 2004, but this data may be exaggerated (<http://www.senat.gov.pl/k6/agenda/seminar/061020.htm> as on 7/12/2006).

Transition countries of Europe

Transition countries of Europe are the countries transforming from so called centrally planned (“socialist”) economic system, and dictatorial rule of communist parties to a Western-European (and sometimes even American) model of free market economy and bourgeois (or liberal) parliamentary democracy. As I argue that the economic system in the former Soviet Union and its satellites was really an extreme, highly bureaucratic form of state capitalism, thus I propose to describe the former Soviet Bloc (and to significant extent also the former Albanian and Yugoslavian) system as “centrally controlled economies”.⁶

Transition countries of Europe can be thus classified as:

I. Former Soviet Republics: Armenia, Belarus, Estonia, Georgia, Latvia, Lithuania, Moldova, Russian Federation, and Ukraine.

II. Central European countries: Czech Republic, Germany (East), Hungary, Poland and Slovakia.

III. The Balkans: Albania, Croatia, Bulgaria, Macedonia, Rumania, Serbia-Montenegro and Slovenia.

As mentioned above, unstable countries without effective central government, such as Bosnia and Herzegovina, entities not independent *de jure* (Kosovo) and not recognised *de jure* (Transnistria) are, for obvious reasons, beyond the scope of this paper. Because of availability of reliable data, I will concentrate the analysis on the former Baltic Republics of USSR,⁷ the Central European countries⁸ and from the Balkans Croatia and Slovenia. Former GDR (DDR) is excluded from this analysis, as it is, at the moment (year 2006) for more than a decade a full member of the EU, so it can be treated as an “old” member of this union.

Institutions of Labour market

They consist, generally, of various forms of labour market regulations, such as:

1. Employment Protection Legislation (EPL) i.e. hiring and firing rules governing unfair dismissals, layoffs for economic reasons and similar limitations for employer to dismiss workers at will.
2. Wage setting institutions.
3. The unemployment benefits systems.
4. Active labour market policies.
5. Taxes on labour.

The disappointingly poor employment performance and persistent high unemployment in the transition countries of Eastern Europe, and especially in Poland is explained by the practitioners of orthodox⁹ economic theory by different factors, but usually by “ongoing macroeconomic and structural reforms” (Nesporova, 2002).

⁶ It can be also argued that as economic plans were, as a rule, not fulfilled (for mostly political reasons and, to a lesser extent, technical), so it was a mistake to name those economies “planned”. As to other aspect of planning, namely spatial planning: the “communist” countries of Europe significantly lagged in this aspect behind the capitalist and free market Western part of the continent. Thus can be concluded that the “socialist” economy was not really based on plans, but rather on arbitrary, political decisions made by the senior members of the “inner” communist party, who, as a rule, lacked genuine expertise in economics. This also explains, at least in part, the failure of the “socialist” economic model in its Eastern and Central European version.

⁷ Estonia, Latvia and Lithuania.

⁸ Czech Republic, Hungary, Poland and Slovakia.

⁹ Here mostly practitioners of neo-classical and monetarist schools, such as recently deceased American economist Milton Friedman and his followers.

Table 1. Unemployment rates in selected European transition countries 1990-2005

Country	1990	1992	1994	1996	1998	2000	2005
Albania ^{a)}	35.0	50.0	18.0	12.1	14.0	17.0	14.8
Armenia	.	.	6.0	9.4	9.4	10.9	30.0
Belarus	2.9	5.0	1.8	3.1	2.8	2.1	2.0
Bosnia & Herzegovina ^{b)}	.	.	28.0	45.5	35.0	39.9	44.0
Bulgaria	1.7	16.4	12.8	11.1	14.4	18.7	12.7
Croatia	.	.	17.3	15.2	18.6	14.8	13.8
Czech Republic	1.0	2.6	4.1	3.1	7.3	8.8	10.6
Estonia	.	1.0	7.6	5.5	9.9	13.5	9.6
Georgia	.	.	3.8	3.0	14.5	17.0	18.0
Germany (East)	7.3	14.8	16.9	16.0	18.2	17.0	18.5
Hungary	1.7	12.3	10.7	10.9	7.8	6.6	5.9
Latvia	.	4.4	6.5	7.1	7.6	10.4	8.8
Lithuania	0.2	5.0	4.5	7.0	6.1	11.8	8.0
Macedonia	.	24.8	33.2	38.9	32.3	45.1	37.7
Moldova	4.2	4.2	1.0	1.5	2.0	1.9	8.0
Poland	6.4	13.6	16.0	14.2	10.5	16.6	20.3
Rumania	3.1	8.5	10.9	7.5	9.0	7.2	6.3
Russian Federation	1.0	1.5	7.1	9.1	13.3	13.4	8.3
Serbia-Montenegro ^{c)}	13.6	24.3	23.1	25.7	30.0	30.0	20.0
Slovakia	4.9	10.4	14.8	12.6	12.5	19.1	13.1
Slovenia	8.2	11.6	14.2	13.8	7.7	7.1	6.4
Ukraine ^{d)}	3.1	4.0	7.0	7.6	11.3	11.9	3.8
CIS ^{e)} average	.	.	4.4	6.1	.	.	.
Eastern Europe average.	.	.	13.6	12.1	.	.	.

Sources: Official data CIA, ILO, IMF, OECD and UN

- a) Unemployment rate in Albania was officially 14% in 1998, but is likely to be as high as 28%, data for 1992 comes from Encyclopaedia Britannica and is likely to be an overestimate.
- b) Unemployment rate in Bosnia-Herzegovina was estimated in 1998 to be between 35% and 40%.
- c) Data for Serbia-Montenegro without Kosovo; in 2005 when Kosovo included the rate of unemployment was 31.6%; in 1998 the rates were for Montenegro 27.6% and for Serbia 30%.
- d) Ukraine has 3.8% officially registered unemployment, but the International Labour Organisation calculates that Ukraine's real unemployment level was in 2005 around 9-10%.
- e) CIS (Commonwealth of Independent States): former USSR minus Baltic countries (Estonia, Latvia and Lithuania – now members of the EU).

Employment Protection Legislation

Employment protection legislation (EPL) refers to hiring and firing rules. As it was stated previously, these rules are designed to protect the welfare and basic (here mostly economic) human rights of workers. According to the orthodox, mostly neo-classicist economists, EPL is not much more than a hindrance for economy as it induces additional costs for employers. It must be understood that under the “communist” rule¹⁰ workers enjoyed a very high degree of employment protection, and unemployment there was virtually unknown there – see Table 2.

Orthodox economists claim thus that “this high degree of employment protection, combined with high wage compression, led to extreme labour rigidity and inefficient labour allocation” (Cazes 2002 p. 8). It was taking power by the right wing parties, parties that represented mostly the capital, that made it possible to virtually dismantle the welfare state institutions in

¹⁰ In other words in so called centrally planned economies, which were (as I explained before) really a highly bureaucratic form of state capitalism - thus my description of this system as “centrally controlled economy”.

the former “communist” countries of Europe. That diminishing position of labour versus capital can be observed by effective elimination of workers’ rights and weakening of trade union power practically in all of the transition countries of Europe.¹¹

Measuring EPL is a most difficult task and depends very much on the availability of the data. For western industrialised countries, various summary indicators are available from the International Institute for Labour Studies Discussion Paper No. 140. Roughly speaking, the countries of Southern Europe have the strictest regulations, and these regulations are weakest in the north. It is assumed by OECD experts that Switzerland, Denmark and the UK have the lowest level of workers protection in Europe.¹² Table 3 contains selected indicators for the transition countries in Europe, which indicators are based on OECD methodology (OECD 1999). These indicators are, however, based on rather arbitrary a weighting scheme (see Annex 1) so they should be accepted only conditionally, in no case as a true and unbiased indicators of the real state of things.

Table 2 Unemployment rates in selected countries 1920-2006

Country (group)	1920 (a)	1929 (a)	1930 (a)	1933 (a)	1937 (a)	1945	1948	1950	1955	1960	1965	1970	1971	1972	1973	1974
Australia ^b	11.2	11.1	19.3	25.1	10.5	1.5	2.0	1.7	1.4	2.4	1.3	1.6	1.9	2.6	2.3	2.6
Canada	.	.	.	.	.	.	.	.	.	.	.	5.8	6.1	6.1	5.6	5.2
EU ^c	X	X	X	X	X	X	X	X	X	2.5	.	3.0	.	3.0	.	.
France	.	.	.	.	.	.	.	.	.	.	.	3.0	3.0	3.0	2.8	2.8
Germany	3.8	13.1	15.3	26.3	4.6	.	4.2	.	.	.	0.6	0.8	0.8	0.9	1.0	2.6
East	X	X	X	X	X	X	X	.	.	.	0.0	0.0	0.0	0.0	0.0	0.0
West	X	X	X	X	X	X	X	10.3	5.1	1.2	1.0	2.1	2.1	2.3	2.4	2.5
Japan	.	5.0	7.0	.	4.0	.	0.7	1.3	1.8	1.6	0.8	1.1	1.1	1.1	1.0	1.5
OECD	X	X	X	X	X	X	X	X	X	X	.	3.1	3.6	3.7	3.3	3.5
Poland ^c	3.0	4.5	10.5	31.5	25.9	1.8	0.8	0.0	2.2	0.3	0.5	0.5	0.6	0.4	0.3	0.2
UK	14.0	8.0	18.0	22.5	9.0	0.5	1.6	1.6	1.1	1.6	1.5	2.6	3.0	3.4	2.2	3.0
USA	5.2	3.2	8.9	25.9	14.3	1.9	3.8	5.0	4.4	5.5	6.0	4.9	5.9	5.6	4.9	5.6
Country (group)	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Australia ^b	4.8	4.7	5.7	6.2	6.2	6.1	5.7	7.1	10.7	8.9	8.3	8.0	8.0	7.1	6.1	8.2
Canada	6.9	7.0	8.0	8.1	7.2	7.2	7.2	10.6	11.5	10.9	10.0	9.1	8.1	7.3	7.1	8.6
China ^c	.	.	.	.	.	5.0	4.0	3.0	2.0	2.0	1.8	1.9	2.0	2.2	2.3	2.5
EU ^d	.	.	5.2	5.4	5.4	6.0	8.6	9.8	10.2	10.4	10.1	10.2	10.6	9.2	9.0	7.4
France	4.1	4.4	4.8	5.2	5.4	5.8	7.2	7.8	8.6	9.8	10.2	10.3	10.4	9.8	9.4	9.0
Germany ^d	3.0	3.0	3.1	3.0	2.8	2.8	3.6	5.0	6.5	6.8	6.0	5.2	5.1	5.0	4.6	6.2
East	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	7.3
West	3.4	3.4	3.5	3.4	3.0	2.9	4.1	5.9	7.5	7.8	7.2	6.5	6.3	6.2	5.6	4.8
Japan	1.9	2.0	2.0	2.2	2.1	2.0	2.2	2.4	2.6	2.7	2.6	2.8	2.8	2.5	2.3	2.1
OECD	5.2	5.3	5.3	5.2	5.1	5.8	6.3	7.6	8.1	7.7	7.6	7.6	7.2	6.5	6.0	5.9
Poland	0.1	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	1.1	6.5
UK	4.5	6.0	7.0	6.3	5.6	7.4	10.7	12.5	12.8	13.2	11.2	11.2	10.3	8.5	7.1	6.9
USA	8.5	7.7	7.1	6.1	5.8	7.2	7.6	9.7	9.6	7.5	7.2	7.0	6.2	5.5	5.3	5.8
Country (group)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 (e)
Australia ^b	9.7	10.8	10.9	9.7	8.6	8.5	8.6	8.2	7.1	6.3	6.8	6.4	6.1	5.5	5.5	5.0
Canada	10.0	10.6	10.8	9.5	9.9	9.0	8.5	8.7	7.6	6.9	7.2	7.7	7.8	7.2	7.2	7.0
China ^c	2.4	2.3	2.6	2.8	2.9	3.0	3.1	3.1	3.1	3.1	3.6	4.0	4.3	4.5	4.0	.

¹¹ It is an interesting and somehow puzzling paradox: in Poland, the largest of those transition countries (Ukraine, a former Soviet Republic is outside the scope of this paper) it was the trade union “Solidarity” and its former leader Lech Wałęsa, who dismantled the workers’ protection system and introduced high unemployment as inevitable consequences of so-called Balcerowicz Plan – a plan to choke the high inflation, then endemic in Poland of the late 1980s, by highly restrictive monetary policy, which had to produce so large and so lasting unemployment.

¹² UK has roughly the US level.

France	9.4	10.3	11.7	12.3	13.6	13.5	13.5	13.6	11.0	9.1	8.4	8.9	9.5	9.7	9.5	8.0
Germany ^d	6.7	7.7	10.1	11.3	10.1	8.8	9.2	8.7	8.8	7.3	7.4	8.1	8.7	9.7	8.5	9.0
East	10.3	14.8	13.5	16.9	16.9	16.0	17.0	18.2	17.6	17.0	18.0	18.0	18.0	19.0	18.5	.
West	4.2	6.4	7.7	8.2	8.0	8.7	9.7	9.1	8.4	7.8	7.8	8.7	9.7	10.0	9.5	.
Japan	2.1	2.2	2.5	2.9	3.2	3.4	3.4	4.1	4.7	4.7	5.0	5.4	5.3	4.7	4.5	4.0
OECD	6.6	7.3	8.0	7.9	7.6	7.5	7.2	7.1	6.7	6.3	6.5	7.0	7.1	6.9	6.7	.
Poland	12.2	14.3	16.4	16.0	14.9	13.2	10.3	10.4	13.1	15.1	17.5	19.7	20.0	20.6	20.3	18.0
UE ^f	7.5	8.3	9.9	10.7	10.5	10.7	10.7	10.2	9.4	8.4	8.0	8.4	8.8	9.0	8.5	8.3
UK	8.6	10.3	10.0	9.2	8.5	8.0	6.9	6.2	5.9	5.5	5.1	5.2	5.1	4.8	4.8	4.0
USA ^b	6.8	7.5	6.9	6.1	5.6	5.4	4.9	4.5	4.2	4.1	4.9	5.8	6.1	5.7	5.3	5.0

- a) Estimates not entirely comparable with later years due to changes in methodology and in definition of unemployed.
- b) Significant changes in methodology in Australia in 1970 and in USA in 1990 and 1994.
- c) PRC (People's Republic of China) since 1950.
- d) Since 1990 East=former eastern lands, West=former western lands.
- e) For 1930 real rate for blue collar workers (official rate was 4.9% in 1929 and 7.5% in 1930).
- f) Since 2000 only "Euroland" (Eurozone).
- g) Based on IMF estimates of early 2006.

Table 3. Employment Protection Legislation indicators in selected transition countries

Country	Max pay & notice period (1)	Difficulty of dismissals (2)	Index for regular contracts (3)	Index for regular & temporary contracts (4)	Index for regular & temporary contracts & collective dismissals (5)
Bulgaria	7.0	2.9	2.3	2.5	2.8
Czech Republic	5.0	3.2	3.0	1.8	2.2
Estonia	8.0	2.9	2.9	2.1	2.4
Hungary	8.0	2.5	2.1	1.5	1.8
Poland	3.0	2.7	2.3	1.7	2.0
Russian Federation (a)	5.0	3.5	3.3	2.9	3.2
Slovakia	4.0	2.4	2.6	1.9	2.3
Slovenia	16.0	4.5	3.4	3.0	3.3
Transition average (a)	.	3.1	2.7	2.2	2.5
EU average (b)	.	.	2.4	2.2	2.4
OECD average (c)	.	.	2.0	1.9	2.0

Source: Cazes (2002) p. 9

Note: These estimates are given for 1999, i.e. before the recent revisions of the labour codes of Bulgaria, the Russian Federation and Slovenia.

- (1) The sum of maximum notice and severance pay, in months (author's calculations).
- (2) Covers the strictness of the legal definitions of unfair dismissal, the frequency of verdicts involving the reinstatements of the employees and the monetary compensations typically required in the case of unfair dismissals.
- (3) Summary score for overall strictness of protection against dismissals.
- (4) Weighted average of indicators for regular contracts and temporary contracts.
- (5) Weighted average of indicators for regular contracts, temporary contracts and collective dismissals.

- (a) Unweighted averages for transition, EU and OECD countries.
- (b) Does not include Greece and Luxembourg
- (c) Selected OECD countries

Table 3 can be interpreted in the following way: the indicators in columns (2) to (5) take integer values 1 to 6. Countries with most flexible EPL have a low overall index, whilst countries with a strict legislation have a high index. It can be easily seen that the transition countries do not constitute a homogeneous group. As to the strictness of the legislation: Hungary, Bulgaria and Poland are amongst the most flexible, and are followed by Estonia and Czech Republic. On the other hand, Russian Federation has the most restrictive EPL from the employers' view. Generally Hungary is hailed by the capital as the least restrictive transition country, and is followed by Poland and Czech Republic, while Russian Federation and Slovenia are put on the opposite side of this, rather arbitrary, scale. As to the overall EPL strictness: it has the lowest value for Hungary and Poland and the highest value again for Russian Federation and Slovenia. Therefore Cazes (2002 p. 10) concludes that "substantial disparities do exist among the transition countries, with Hungary having the most flexible legislation, closely followed by Poland and the Czech Republic, while the Russian Federation and Slovenia tend to be the most restrictive."

Therefore it can be safely claimed, that high levels of unemployment in Poland are not a result of too rigid legislation, but rather result of restrictive monetary policies of Balcerowicz and his followers, policies that restricted aggregate demand in name of stable currency and low inflation, and thus caused persistently high level of unemployment in Poland.

Unemployment benefit systems and active labour market policies

Traditionally, labour market policies are classified as:

- 1. Passive:**
 - a.* unemployment insurance schemes and
 - b.* early retirement schemes and
- 2. Active:**
 - c.* job mediation,
 - d.* labour market training,
 - e.* job creation by
 - i.* public works and
 - ii.* subsidised employment and
 - f.* labour mobility measures.

The transition economies have introduced, with various effects, a wide range of labour market programmes, both active and passive. The aim of these policies was officially "to relieve tensions in the labour market and provide income support for the unemployed". I start my critical analysis with the most popular one, i.e. unemployment benefit schemes.

Unemployment benefits schemes

Over the period 1990-2005, unemployment insurance system has increasingly become less generous in the analysed countries. This worrying tendency can be captured by the lowering of the level and the duration of the benefits, as well as tightening of the eligibility rules. Table 4 presents the main features of the unemployment insurance system in the selected transition countries of Europe, such as:

- replacement rates, (the share of income which is replaced by unemployment benefit),

- the duration of the benefit, and
- the share of benefit recipients in the total number of registered unemployed.

Table 4 presents some trends that are dangerous not only to the social cohesion of those countries, but also to the general condition of their economies. For example: the ratio of initial (usually the highest) levels of benefits to previous earnings of benefits in the selected transition countries were in relatively high range 40% - 75%. The only exceptions were Estonia with 10% and Ukraine with 100%. It can be seen that extreme of ultraliberal Estonia leaves its unemployed without enough income for even biological survival,¹³ while it is obvious that 100% rate in Ukraine does not create any initiative to seek employment, at least during the eligibility period.¹⁴

An alternative way used by Cazes was to compare the benefit level across various countries was to express the average benefit as percentage of the average wage (second column of table 4). As to duration of unemployment benefits: it was in the late 1990s shortest in Czech Republic and Estonia (6 months) and longest in Slovenia and Russia (2 years). It should be noted that some OECD countries such as Australia have unlimited duration of such benefits (however at a cost of their relatively low level, usually linked only to the average income, not previous income of the unemployed).

As to the coverage rates, i.e. percentage of unemployed receiving unemployment insurance benefits (dole): these rates also show large variation across different analysed countries, as they vary from around 20% to even 90%. Those rates remained fairly stable in Czech Republic, Estonia and in Hungary, but have fallen dangerously and continuously in Poland, Slovakia and (to a lesser extent) in Slovenia.

Table 4. Characteristics of the unemployment insurance system in selected transition countries in 1998

Country	Benefit Replacement ratio (1)	Benefit replacement ratio (2)	Benefit duration (3)	Coverage rates (4)
Bulgaria	60%	32.0%	6-12 months depending on age and length of employment	24.8%
Czech Republic	60%	24.0%	6 months	48.8%
Estonia (a)	7%	7.0%	6 months	59.3%
Hungary (b)	65%	27.5%	3-12 months depending on length of employment	73.9%
Poland (c)	40%	36.0%	12 months	23.1%
Russian Federation	75%	25.5%	12-24 months	89.5%

¹³ Note relatively low level of real wages in Estonia especially taking under consideration rather harsh climatic conditions of this country that require additional spending on clothing and heating during the long and severe Estonian winters.

¹⁴ As unemployed on a dole that equals his or hers former wage (salary) does not have to spend money for such items as travel to work or formal clothes (dress) and has also plenty of additional free time, his or hers wellbeing is (at least temporary, i.e. during the period of eligibility) definitely better than when he or she used to work.

(d)			within 36 months	
Slovakia	60%	32.8%	6-12 months depending on length of employment	27.0%
Slovenia	63%	43.9%	3-24 months depending on length of employment	32.6%
Ukraine	100%	22.7%	180-360 days within 2 years	53.1%

Source: Cazes (2002) p. 13

- (1) This replacement rate is measured by the average benefits as a percentage of gross average wage
- (2) Initial benefits level divided by previous earned wage
- (3) Duration of payment
- (4) Percentage of unemployed receiving unemployment insurance benefits

- (a) Flat rate of EEK 300
- (b) The ratio in the last column includes means-tested unemployment assistance, once UB are exhausted. In contrast with other transition countries, this de facto social assistance is paid from the Labour Market Fund while in other countries it usually is paid from social budgets.
- (c) Column 2: Flat rate of 393.60 Polish zloty in June 1999.
- (d) Column 2: It broadly corresponds to 42 per cent of the national subsistence level in 1997

Labour market policies

Most of the analysed transition countries adopted various packages of labour market policies, including so-called *active labour market policies* (ALMP), such as:

- job mediation and counselling,
- vocational guidance,
- labour market training,
- employment subsidies,
- direct job creation,
- small business promotion and
- various measures targeted at youth and other disadvantaged groups, such as disabled.¹⁵

There are again significant differences with regard to the number of participants in those schemes and in resources devoted to the mentioned active labour market policies, as well as in the distribution of unemployed between different active programmes in different countries. Among the analysed transition countries, Slovenia is the leader in spending on active labour market programmes, while Estonia spends around 10 times less. However, on average the level of expenditures on ALMP is rather low in the analysed transition countries: it is measured as percentage of GDP, from 0.08 % in Estonia to 0.83% in Slovenia. Adjusting these figures for the unemployment rate (by calculating the ratio of GDP spent on active labour market policy to unemployment rate) confirms that transition countries do not spend large amounts on active labour market policies. The ratio was in 1998 from around 0.002% of GDP for Russia to 0.11% of GDP in Slovenia – see Table 5. Therefore, Cazes (2002 p. 14) claims that “these figures are close to some OECD countries that have low expenditures on ALMP, such as the United States or Japan”. Also note that there are substantial differences among OECD members: the Netherlands and Denmark are among the “high spending” OECD

¹⁵ Detailed presentation of those programmes can be found in Nesporova (1999).

countries, with 0.55% and 0.34% of GDP spent on active policies per one per unemployed against 0.16% and 0.14% on average for the EU and the OECD respectively.

These differences between analysed countries are also in the level of spending on labour market programmes devoted to passive policies (as in Table 5). Generally, the transition countries spend less than 1% of their GDP on unemployment insurance. The differences are quite significant in area of spending on passive programmes and range from 0.9% of GDP in Slovenia and 0.56% in Hungary to less than 0.1% in Estonia. Generally, these figures are still lower than those of the “old” EU countries, which devote on average 1.73% of GDP to those passive programmes. The same conclusions can be drawn by comparing the spending per unemployed person.

Table 5. Spending on passive and active labour market policy in selected transition countries in 1998

Country	Total expenditure as % GDP (1)	of which: passive policies (2)	of which: active policies (3)	Passive spending per unemployed person (4)	Active spending per unemployed person (5)
Bulgaria	0.80	0.46	0.12	0.029	0.007
Czech Republic	0.40	0.26	0.05	0.036	0.007
Estonia	0.20	0.10	0.07	0.010	0.007
Hungary	1.30	0.91	0.28	0.117	0.036
Poland	1.00	0.59	0.30	0.056	0.028
Russian Federation	0.20	0.13	0.02	0.010	0.002
Slovakia	1.10	0.56	0.32	0.044	0.026
Slovenia	1.72	0.89	0.83	0.110	0.110
Ukraine	0.30	0.19	0.03	0.017	0.003
EU average	.	.	.	1.160	0.160
OECD average	.	.	.	0.920	0.140

Source: Cazes (2002) p. 14

Note: The difference between column (1) and column (2) and (3) relates to the costs of running national public employment services.

(1) Spending per unemployed: ratio of GDP spending on LMP to LFS unemployment rates

(4) Spending per unemployed: ratio of GDP spending on UI to LFS unemployment rates

(5) Spending per unemployed: ratio of GDP spending on ALMP to LFS unemployment rates

Trade unions and wage bargaining

In most of the analysed countries trade unions play a major role in the collective bargaining process and are therefore likely to influence the wage formation and labour costs. Even in countries where the number of unionised workers is relatively low, collective agreements can actually cover a large share of workers. This is the case for example of France and Spain. Another relevant aspect to consider here is the extent to which they manage to co-ordinate their wage setting activities together with employers' organisations. In table 6 there are presented the key features of the trade unions, such as:

- the union “density”,

- coverage by unions of collective agreements and
- levels of co-ordination.¹⁶

Before 1990, the industrial relations systems of transition countries were characterised by central political and managerial control exercised by the state, and within it by the ruling (“communist”) party. During the period 1990-2005 efforts were made in order to develop industrial relations system typical for market economy, or in other words, as in the West. The transition countries have thus started to move away from a centralised wage setting system, towards a collective bargaining system in the free (private) enterprise sector. According to available data, the percentage of trade union membership ranges from about 34% cent in Poland¹⁷ to 74% in Russia. Collective bargaining coverage,¹⁸ however, is high (over 70%) in the majority of transition countries (except in Bulgaria, Czech Republic and Estonia). Yet, despite a rather homogeneous cross-country picture indicating a rather high level of union membership and coverage, significant differences have emerged between the public and the private sectors, with much lower unionisation of workers in the latter sector. Moreover, as it can be argued that unions’ negotiation power depends very much on their co-ordination ability with employers, which is now actually rather low in most of the analysed transition countries, so this also affects negatively the power of trade unions.¹⁹

Table 6. Trade unions and collective bargaining in selected transition countries in the mid 1990s

Country	Union density in % (1)	Central bargaining coverage (2)	Degree of co-ordination (3)
Bulgaria	58.2	2	3.0
Czech Republic	42.8	2	1.0
Estonia	36.1	2	1.5
Hungary	60.0	3	1.5
Poland	33.8	3	1.5
Russian Federation	74.8	3	3.0
Slovakia	61.7	3	2.0
Slovenia	60.0	3	3.0
Ukraine	100.0	3	3.0
EU average	44.4	.	.
OECD average	39.6	.	.

¹⁶ Co-ordination may be distinguished from centralisation, which refers to the level of the bargaining (plant, firm, industry, and country level). Highly co-ordinated bargaining is not necessarily centralised, as, for example, in Germany and Denmark.

¹⁷ Note that in the early 1980s virtually all Poles working in the (then) dominating state industrial sector were members of the Solidarity trade Union (it claimed more than 10 million members in 1981).

¹⁸ The number of workers (unionised or not), who have their pay and working conditions determined by collective agreements in the private enterprise sector.

¹⁹ In OECD countries the picture is different and shows greater diversity. Both the percentage of employees who belong to trade unions and those who are covered by collective agreements differs widely across the countries. Trade union density ranges between less than 10% in France compared to 82% in Sweden. In USA less than 25% of workers have their wages determined by collective agreements, while this percentage is above 70% in most of the OECD countries. Furthermore, the degree of co-ordination varies across countries. The most co-ordinated organisations are in Scandinavia and Austria, followed by the continental Europe. The Anglo-Saxon countries show little co-ordination. It could be said that workers in transition countries are still more unionised than in the ‘old’ EU and in whole OECD, while as for the strength of trade unions and co-ordination of collective negotiations the transition countries fall more or less within the OECD average.

Source: Cazes (2002) p. 14

Notes:

1. Percentage of salaried workers that belong to a trade union.
2. Collective bargaining coverage index takes a value of 1 when collective agreements cover less than 25 per cent of all salaried workers, 2 if this number is between 26 and 69 per cent and 3 when coverage is above 70 per cent.
3. The degree of union and employer co-ordination is measured through an arbitrary index that ranks from 1 (low) to 3 (high). The overall co-ordination is obtained as the average of union and employer co-ordination.

Taxes on labour

As taxes on labour are usually understood such taxes as:

- income taxes,
- payroll taxes and
- consumption taxes.

The main argument is that the impact of taxation on the labour market operates via the so-called wedge or difference between the real labour cost and the real consumption wage received by the worker. The most important are the income taxes, and secondly the consumption taxes, but only payroll taxes are related exclusively to the employed persons (as not only workers but also unemployed and inactive on labour market persons pay income and consumption taxes).

Payroll taxes are defined as the difference between real labour cost paid by employers and after tax real consumption wages received by workers:

$$T_P = C_L - W \text{ or}$$

$$C_L = W + T_P$$

T_P – Payroll Tax (Tax on Payroll)

C_L – Cost of Labour (for the firm)

W – Wages (Payroll) paid by the firm to the workers

Payroll taxes should be regarded as an important barrier to growth of employment, as they artificially increase cost of labour. Unfortunately, they are relatively easy to administrate, so they are popular among the politicians and bureaucrats. In analysed transition countries, they are generally high: from 33% in Estonia to as high as 50% in Slovakia.²⁰

As fiscal revenues considerably fall in periods of economic contraction, thus there are strong pressure on maintaining high payroll taxes, and it can be also argued that such pressures are magnified by such factors as ageing population, declining employment rates and elevated poverty levels, which also put additional constraints on the funding of public pension schemes, health care and social welfare. With respect to negative effects of high taxation on employment and business development some countries started to lower their payroll taxes and saw amendments and fiscal reforms taking place, though at a slow and gradual pace over the last decade of 20th century.

²⁰ Payroll taxes in OECD countries do not exceed, as a rule, 40%: they were in the middle 1990s from almost 0% in Denmark to 38.8% in France and 40.2% in Italy.

* * *

It can be said in this place that the analysed transition countries possess a set of labour market institutions which is broadly similar to that of the “old” EU. In other words: at the end of the 20th century and beginning of the 21st century most of the analysed transition countries have adopted a set of labour market institutions that broadly resemble those in the “old” European Union. Therefore it can be also argued, that adding the nine transition countries to the OECD and EU did not increase diversity of these institutions in a dramatic way. The analysed transition countries opted for a rather average institutional package: neither the most, nor for the least flexible model. The case of the employment protection legislation is rather straightforward: the transition countries can be placed in the middle range of the flexibility scale. Only important exception to this pattern is for payroll taxes, which are clearly have much higher rates in the transition countries than in the “old” EU.

The impact of labour market institutions on labour market outcomes

Principles governing the impact of labour market institutions

The strictness of the employment protection legislation may affect both employers’ and employees’ decisions. Thus the main argument for employment protection relates to such factors as worker welfare, implicit contracts, the advantage of a stable employment relationship (which encourages investment in so-called human capital), and the social cost of dismissals and, last but not least, issues connected to macro-economic stability. The main argument against employment protection is that it is supposed to constrain firms’ behaviour, which causes raising labour costs and hence might reduce total employment.²¹

The net impact of these favourable and unfavourable effects on labour costs, employment and productivity is likely to vary between size of firms, type of activity and according to the economic conditions. In a nutshell, stricter employment protection legislation may, according to the orthodox school, contribute to lower participation rates and lower employment levels, and thus may lead to higher unemployment rates - in particular long-term unemployment rates and longer periods of unemployment. It may also contribute to significant labour market segmentation by guaranteeing high job stability and security for regular workers, while increasing labour turnover and uncertainty for the other categories of workers (mostly casual and part-time employees). From a dynamic perspective that is considering jobs or workers flows instead of stocks of jobs and workers, even orthodox theoretical models show that employment is more stable and individual employment relationships more durable when EPL is stricter. In other words, inflexible EPL reduces mostly levels of hiring and firing, which is a rather obvious conclusion. Orthodox economic theory suggests as well that generous unemployment benefit systems influence the labour market outcomes via two mechanisms:

- *Firstly*, they discourage job search by the unemployed (by increasing their reservation wage²²) and
- *Secondly* they reduce the “fear” of unemployment, and hence create upward pressure on wages (via labour unions or in other ways).

²¹ More detailed survey of the principles governing the impact of hiring and firing rules on general economic well-being can be found in Cazes and Nesporova (2003).

²² Reservation wage is a concept in labour economics that suggests that “each worker has a specific wage rate whereby they are induced to perform paid market work. Wages offered below a worker's reservation wage would keep said worker from participating in the labour force” - http://en.wikipedia.org/wiki/Reservation_wage as on 07/12/2006.

It is obvious that labour (trade) unions affect the labour market. Trade unions (and, more generally, the industrial relations systems), play a vital role in determining wage flexibility in response to external and internal economic shocks. According to certain characteristics and factors, such as:

- the degree of co-ordination in wage bargaining,
- the level at which bargaining takes place,
- the union density and
- the coverage rate of collective bargaining,

trade unions may influence the wage negotiation process through:

- setting of the minimum wage,
- bargaining about wage increases and
- shaping of the wage structure.

Co-ordination is a particularly important aspect to ensure consensus in bargaining on macroeconomic objectives: wage increase negotiations may (for example) take the precedence over negotiations on other issues, creating upward wage pressure and higher equilibrium unemployment (as is argued by Bertola, 1990); but unions may also set employment goals and accept wage restraint, trading wage moderation against additional employment creation, as recently happens in such countries as Germany, Switzerland and The Netherlands.

The indicators presented in Table 6 (union density, coverage of central bargaining and degree of co-ordination) are likely to shape the level of employment (and thus unemployment), by influencing labour market outcomes, namely trade union policy.

Evidence in OECD countries

It is interesting that empirical analyses conducted in western industrialised countries provide ambiguous results as to the impact of labour market institutions on labour market outcomes. The main findings can be summarised in the following way:²³ generally EPL (employment protection legislation) has little or no effect at all on overall unemployment levels, but it may affect its structure, for example duration of unemployment. Period (length) of unemployment duration is supposed to increase with stricter EPL. OECD analyses found also a rather clear negative correlation between EPL strictness levels and the participation rates across countries, but a positive effect of EPL strictness on the rate of employment for prime age men (but likely at the detriment of youth, women and less skilled workers). . EPL also affects job and labour flows: labour turnover, in general, declines with stricter EPL and vice versa. Interestingly, Poland may be regarded an exception as some recent analyses (such as World Bank, 2001) suggest a negative impact of the minimum wage (set around 40% of the average wage) on employment of low-skilled workers in less developed Polish regions due to much lower wage and price levels there. More details are in Tables 7 and 8.

²³ Compare OECD Job study (1994); OECD Employment Outlook (1999); Nickell (1997), and Bertola *et al.* (1999).

Table 7. Youth unemployment rates in selected counties 1962-2004

Country	1962	1975	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2004
Australia	.	13.0	12.2	14.0	13.2	17.1	19.5	18.6	16.2	14.4	14.8	15.9	14.5	13.9	12.3	12.7	12.4	11.6
Canada	.	.	.	25.0	12.4	15.8	17.1	17.1	15.8	14.7	15.3	16.2	15.1	14.0	12.6	12.8	13.7	17.0
China	.	.	.	2.0	2.5	2.3	2.3	2.6	2.8	2.9	3.0	3.0	3.1	3.1	3.1	.	.	.
EU	.	.	.	22.0	16.0	19.0	18.3	20.0	21.7	21.6	21.5	20.0	18.5	16.9	15.4	14.6	15.1	15.0
France	.	8.0	15.0	23.0	19.1	19.4	20.8	24.6	27.5	25.9	26.3	28.1	25.4	26.5	20.7	18.7	20.8	25.0
Germany	.	.	.	9.5	5.4	5.4	6.2	7.6	8.2	8.2	9.4	10.2	9.0	8.6	8.4	8.3	9.7	10.6
East	0.0	0.0	0.0	0.0	.	.	.	.	.	.	X	X	X	X	X	X	X	X
West	.	.	.	9.5	3.0	4.0	5.0	6.0	7.0	8.0	X	X	X	X	X	X	X	X
Japan	.	.	.	5.0	7.0	7.3	7.6	8.9	8.0	8.0	9.0	10.0	15.9	14.0	10.2	9.7	10.0	10.1
Korea ^{b)}	7.0	7.3	7.6	8.9	7.2	6.3	6.1	7.6	15.9	14.0	10.2	9.7	8.1	.
OECD	13.9	15.4	.	.	.	.	.	11.8	.	.	13.2	13.4
Poland	0.0	0.9	0.0	0.0	28.3	28.0	27.8	30.0	32.6	31.2	28.5	24.7	23.2	31.3	35.2	42.0	43.9	41.1
UK	.	.	.	23.0	10.1	13.6	15.5	17.4	16.6	15.3	14.9	13.5	12.4	12.3	11.8	11.9	11.0	11.5
USA ^{a)}	11.8	16.3	19.6	18.6	15.0	13.4	14.2	13.8	12.5	12.1	12.0	11.3	10.4	9.9	9.3	10.6	12.0	19.3
World	6.6	.	.	.	.	.	.	.	.	14.4

a) Changes in methodology in 1990 and 1999

b) South Korea

Table 8. Long term unemployed^{a)} as a % of all unemployed in selected countries 1979–2003

Country (group)	1979 Total	1985 Total	1989 Total	1991 Total	1992 Total	1993 Total	1994 Total	1998 Total
Australia	18.1	34.0	28.4	17.5	34.5	43.8	44.0	.
Germany	.	.	.	.	.	.	.	.
East	0.0	0.0	0.0	.	.	.	.	.
West	19.9	12.0	31.0	29.0	33.5	26.0	30.0	36.0
Japan	16.5	.	20.6	.	15.9	.	.	.
OECD	.	.	.	.	28.8	.	.	.
Poland	0.0	0.0	0.0	.	34.7	.	41.2	.
UE	.	.	.	.	41.7	.	.	.
UK	24.8	.	44.7	.	35.4	.	.	.
USA ^{b)}	4.2	.	7.4	.	11.2	.	.	.

Country (group)	1999 Male	1999 Female	2000 Total	2002 Male	2002 Female	2002 Total	2003 Total
Australia	31.8	25.8	28.7	26.7	19.5	23.7	22.0
France	49.9	54.0	.	.	.	33.8	.
Germany	.	.	51.5	.	.	47.9	50.0
East	.	.	X	X	X	X	X
West	27.4	14.8	X	X	X	X	X
Japan	30.3	32.3	25.5	.	.	30.8	33.0
OECD	32.5	41.8	.	.	.	29.6	.
Poland	.	.	37.9	.	.	48.4	.
UE	34.8	21.6	50.0	.	.	41.4	.
UK	7.4	6.2	28.0	.	.	23.1	22.5
USA ^{b)}	.	.	6.0	.	.	8.5	12.0

a) Over a year

b) Data for the US is not fully comparable to the rest of world. For example, using the same method for the US as for the other countries, we get high 23% in 2003 (compare to relatively low official level of just 12%).

There seems to be no link between the levels of strictness of Employment Protection Law (EPL) and overall level of unemployment in the OECD countries, even if the other

institutional settings are introduced to the empirical analysis. This may be due to such factor as that collective bargaining at the central level seems to alleviate any negative effect of stricter EPL on the level of general unemployment. Empirical research on OECD countries indicates that long-term unemployment benefits may generate higher levels of long-term unemployment, but not *vice versa*: less generous unemployment benefits do not stimulate active job search and thus does not cause higher employment levels, as it seems that all really depends on such macroeconomic indicators as:

- overall labour market situation especially demand for labour,
- size of the informal sector (and thus employment in this sector and demand for informal labour),
- wage level offered in vacant jobs,
- the general quality of social welfare system, etc.

In contrast, active labour policies should facilitate re-entry into the labour market. Empirical research on OECD countries also confirms the greater impact of EPL on the dynamics and composition of unemployment than on its level. For example, studies find the existence of a strong negative correlation between EPL strictness and the inflow rate into unemployment and a positive correlation between EPL strictness and the duration of unemployment (as in Cazes & Nesporova, 2004).

However, there is a problem with establishing the real size of unemployment. For example: the average difference between real and official rates of unemployment in Australia was in years 1991-2001 over 10 percentage points (see Table 9). There were also significant differences between so called natural unemployment rate (defined as such, when general price level as expected by the consumers is the same as observed on the market) and the official rate as reported by the unemployment statistics – see Table 10.

Table 9. Estimates of real unemployment in Australia 1991-2004

Unemployment rate	1991	1993	1995	1997	1999	2001	2004	Average for 1991-2001
Official ^{a)}	7.0	10.0	8.6	8.0	7.6	6.8	5.7	8.0
Real ^{b)}	19.0	22.5	20.0	19.0	17.0	16.0	18.0	18.9
<i>Difference^{c)}</i>	<i>12.0</i>	<i>12.5</i>	<i>11.4</i>	<i>11.0</i>	<i>9.4</i>	<i>9.2</i>	<i>12.3</i>	<i>11.1</i>

Source: Australian Bureau of Statistics

a) Only registered unemployed (eligible for the dole, i.e. unemployment benefit)

b) All unemployed persons (i.e. not working and looking for work)

c) Real minus Official

Table 10. Estimates of natural unemployment rate in USA 1965-1998

Year	Official unemployment rate	Natural unemployment rate^{a)}	Year	Official unemployment rate	Natural unemployment rate^{a)}
1965	4.5	6.1	1982	9.7	6.4
1966	3.8	6.2	1983	9.6	6.3
1967	3.8	6.3	1984	7.5	6.2
1968	3.6	6.4	1985	7.2	6.1
1969	3.5	6.3	1986	7.0	6.1
1970	4.9	6.4	1987	6.2	6.1

1971	5.9	6.3	1988	5.5	6.2
1972	4.6	6.2	1989	5.3	6.2
1973	4.9	6.1	1990	5.6	6.3
1974	5.6	6.1	1991	6.8	6.2
1975	8.5	6.0	1992	7.5	6.2
1976	7.7	6.2	1993	6.9	6.0
1977	7.1	6.4	1994	6.1	5.9
1978	6.1	6.5	1995	5.6	5.7
1979	5.8	6.5	1996	5.4	5.7
1980	7.1	6.5	1997	4.9	5.3
1981	7.6	6.5	1998	4.5	5.3

Source: U.S. Department of Commerce

- a) Natural unemployment rate is defined as such, when general price level as expected by the consumers is the same as observed on the market.

Preliminary evidence in transition countries

The main features of the labour market institutions, as well as their potential impacts on labour market outcomes have been described in the two previous sections. The idea here is to consider theoretical and empirical evidence based on OECD countries and assume that labour market institutions affect (if they do so) labour market outcomes in transition countries through the same mechanisms as in the “old “ EU countries.

Unemployment

The assumption that there is no behavioural difference between the OECD countries (and especially “old” EU countries) and the European transition countries have been tested by such authors as Sandrine Cazes (2002).²⁴ Those studies have found that the institutional variables that seem to have an impact on the overall unemployment rates are:

- active labour market policies,
- collective bargaining coverage and
- labour tax.

The overall effect of the trade unions was found “statistically ambiguous”. The regression coefficients of both the union density and collective bargaining coverage variables were found to be positive, suggesting that powerful trade unions are inversely associated to a decrease in unemployment in line with orthodox theoretical expectations. However, these variables were found to be not statistically significant, so good co-ordination between unions and employers’ organisations could offset the previous effect.

The various schemes of labour market policies have also different effects, although neither the replacement ratio provided by the unemployment benefit system nor the length of time for which the benefit is payable were found to be significant. This may be explained by the presence of transition countries in analysed sample, which clearly exhibit less generous unemployment insurance schemes than the “old “ EU countries, notably regarding the duration of the benefits. The active labour market policy variable was found statistically significant, which suggests that expansion of active labour market programmes may

²⁴ **Do labour market institutions matter in transition economies? An analysis of labour market flexibility in the late nineties** International Institute for Labour Studies Discussion Paper DP/140/2002.

contribute to decrease the level of overall unemployment. On the other hand, the estimated coefficient for the tax burden on labour (i.e. payroll taxes) was found to be positive but low, and only marginally significant, suggesting that higher payroll taxes may only slightly increase the level of unemployment. Finally, the coefficient for overall EPL strictness was found to be very small and statistically insignificant, in line with previous evidence presented for OECD countries.

As to the long-term unemployment rates, the same results are generally obtained as for the overall unemployment rates.²⁵ No evidence was found by Cazes that may suggest that employment protection legislation was influencing the duration of unemployment, contrary to preliminary evidence based on bivariate analysis.²⁶ More generally, collective bargaining coverage and the payroll tax variables seem to have an impact on long-term unemployment, in the sense that an increase in these variables would tend to increase long-term unemployment. This finding by Cazes confirms that the primary focus of collective bargaining has so far been on employment protection of workers covered and on negotiating wage increases, which leaves aside jobless persons and contributes to longer duration of unemployment. This, according to Cazes, calls for an extension of social dialogue to include policies promoting employment and combating unemployment. The regression coefficient of the duration of the unemployment benefit was found by Cazes to be positive but not significant (in line with theoretical assumptions).

Again, active labour market policies may thus partly offset the previous effects by decreasing the level of long-term unemployment. The comparison of the regressions conducted by Cazes for the two samples of countries suggests that the lack of statistical significance of the unemployment insurance variables is probably due (again) to the presence of the transition countries, since the results for solely the “old “ EU countries show stronger coefficients for the replacement ratio variable (see also Scarpetta, 1996).

Labour market institutions may also affect youth unemployment rates. According to Cazes, the same set of variables explains youth unemployment rates and overall unemployment rates, except for trade unions, which do not seem to have an impact at all on youth unemployment rates. Moreover, the duration of the unemployment benefit presents a significant statistical association with youth unemployment (in the sense that longer duration tends to increase it). In the same line, the labour tax is highly significant, according to Cazes, and tends to increase youth unemployment rates. Active labour market programmes, at the opposite, tend to reduce youth unemployment rates.

Cazes also notes that if employers produce much below their potential level (for example during the recession), they do not need to increase their inputs (hire new workers, in particular young inexperienced ones) to better use their capacities. Moreover, they may adjust by laying off redundant workers, starting with young people (last in, first out). Finally, looking at rigidities, there is, at least according to Cazes, no evidence that employment protection influences youth unemployment, although a weak positive link may be found. This result is

²⁵ Several modal specifications have been tested by Cazes in order to estimate the long-term unemployment with different indicators of employment protection strictness as independent variables. Employment protection was found to be not significant. However, Cazes argues that stricter job protection levels (measured by “strength” of EPL, considering regular and temporary employment and collective dismissals) increase the level of long term unemployment.

²⁶ See also Cazes & Nesporova (2003) and note the evidence found for OECD countries: a multivariate analysis conducted by the OECD (1999) shows a positive correlation between EPL strictness and the duration of unemployment.

also consistent with bivariate analysis that finds no effect of employment protection legislation on youth unemployment in transition countries over the last decade (as in Cazes & Nesporova, 2004).

Labour input

The possible impact of labour market institutions on unemployment and labour input arises from the theoretical mechanisms, which are based on numerous assumptions, frequently of strong political and ideological undertones. It should be also remembered that other variables might contribute to explain observed variations across countries in labour input. Those variables are such as:

- early retirement schemes (plans),
- disability benefits schemes and
- factors influencing the participation of women, such as maternity leaves.

Unfortunately, those factors are difficult to quantify, so they are frequently disregarded. According to Cazes (2002 p. 25) employment protection legislation affects unemployment rate, but as it is according to the same author counterbalanced by active labour market policies, so the conclusion is ambiguous, not to say confusing. As to collective bargaining coverage: it is suggested by Cazes that it tends to reduce labour supply; but again, the same author writes that “this impact can be partly counterbalanced if unions and employers organisations co-ordinate their collective bargaining activities”. Finally, payroll taxes and unemployment benefits seem to have, according to Cazes, no statistical effect neither on the employment rates nor on the labour force participation rates. The last remark is in line with evidence on OECD countries, where this is generally the overall tax burden on labour (i.e. the so-called tax wedge) that has a clear negative impact on employment rates – compare Nickell (1997) and Nickell and Layard (1999).

However, the above results seem to be “driven” by the group of “old” EU members. Thus if the transition countries were excluded from the sample, then stronger relationships could be found between employment protection legislation (EPL) or collective bargaining institutions and employment and labour force participation rates. These findings suggest that different patterns characterise labour supply in transition countries compared to so-called western industrialised countries (in this case “old” EU members). According to Cazes EPL is positively correlated with labour force participation in transition countries (+0.3), while it is negative for OECD countries (-0.5). This confirms that the results for employment rates are mainly driven by the “old” EU countries and should therefore be used and interpreted with the greatest caution for the transition countries. This is also consistent with previous findings (see Cazes & Nesporova, 2001). One of key findings, according to Cazes (2002 p. 27), is “the tendency towards a counter-cyclical pattern of labour turnover coupled with a pro-cyclical pattern of job tenure, which is the opposite of what happens in the western industrialised countries”. In Cazes’ paper these differences are explained by the fact that labour reallocation in the transition countries has generally been driven more by the demand side (employers) than by workers’ voluntary decisions because of their (totally understandable) heightened perception of job insecurity.

Summary of the above results

In this place it should be noted that unemployment levels and structure in the transition countries is affected by the institutional setting in an opposite way than in “old” western

industrialised countries. These results should be, of course, interpreted with extreme caution as:

- the scope of this analysis is restricted to the formal sector only,
- the institutional environment is becoming more complex, for example non standard forms of employment have been introduced in the transition countries following the “western” example and finally
- indicators used in this paper and in cited papers are far from perfect - for example: EPL indicators do not address exemptions to the application of EPL in the small enterprises and the enforcement procedures.²⁷

Criticism of welfare state institutions relating to the labour market

Some authors, such as cited here Cazes (2002 p. 6) make such extraordinary claims as that “the strong growth of the informal sector can be interpreted as part of the process of labour market flexibilisation” There are also claims that “some of the institutional schemes [that] have to do with the welfare state, as they provide income guarantees; when considered “too generous” - they are accused of creating unemployment through two mechanisms: work disincentives and wage behaviour” (Cazes 2002 p. 6). Those accusations are obviously class and ideology based, as they shift the blame from the real culprits (nature of free market system especially in the period of accelerated technological progress, that is labour-saving by its very nature) to the victims (the unemployed).

Protests against so called reforms in Employment Protection Legislation

Obviously, especially in the countries with strong labour movement traditions, there is strong resistance against the orthodox neo-classical economic policies that wish to introduce (or reintroduce) so called greater flexibility in the labour market by making it easier for employers to lower wages and dismiss workers at will. This is, in some sense, a return to the “wild”, 19th century capitalism, excesses of which were the root and cause of modern labour (trade) unions and its political superstructure in form of socialist and communist parties, that used to stand behind the bloody revolutions of the 20th century.

So, for example, in France in late March 2006 millions protested against so called “First Employment Contract” (CPE), which allows employers to end job contracts for persons under 26 years at any time during a two-year trial period without having to offer an explanation or give prior warning (BBC, 2006). The French government claim that CPE will encourage employers to hire young people, but students and workers fear that this new legislation will erode job stability in a country where approximately 25% of young workers (18 to 25 years old) are unemployed (more than twice the national average, which was around 25% in year 2005). It should be noted that those protests forced the French government to partially withdraw the CPE legislation at the beginning of April 2006, when this paper was commenced. Therefore, one has to wait before making any final conclusion in this particular matter.

²⁷ Indicators used in this paper are based mostly on the legal (formal) constraints that apply in each country and thus do not capture the degree of enforcement of the laws, which varies between the analysed countries.

Conclusion

In this paper, I made an attempt to analyse the main labour market institutions in European transition countries. The preliminary analysis points to conclusion that these countries have adopted labour market institutions broadly similar to those in the “old” EU (this applies especially to so-called CEE countries, i.e. Central Eastern European countries). It was also found that significant level of diversity exists within the analysed transition countries. The main difference (in relative terms) refers mostly to labour taxation, where transition countries rank among the countries with the highest taxes on labour.²⁸

As to the potential effects of labour market institutions on labour market outcomes: generally, no evidence was found of impact of EPL (employment protection legislation) on the unemployment rates in the transition countries. In contrast, EPL seems to influence labour supply significantly in the sense that stricter employment protection tends to have a negative effect on employment and labour market participation rates. However, it was found out that in transition countries this effect is actually opposite than in the “old” EU countries and that, according to same analyses (such as Cazes, 2002) in the former group of countries more protection leads to higher levels of employment and labour market participation. Therefore, one can conclude that empirical evidence in this specific area is inconclusive and even confusing.

According to orthodox economic wisdom “the key labour market institutions on which policies of transition countries should be focused to improve their labour market situation are collective bargaining institutions and active labour market programmes” (Cazes 2002 p. 28). Moreover, according to Cazes, payroll taxes are positively correlated with unemployment rates, in particular long-term and youth unemployment rates. This suggests that transition countries willing to cut currently high (especially long-term and youth) unemployment rates may conceive to gradually reduce extensive payroll taxes (providing that there is indeed a causal link between unemployment and payroll taxes).

Therefore, policies promoting social dialogue, especially aimed at extending it to pay higher attention to employment promotion and unemployment reduction and to ensure more labour market stability, rather than pure deregulation, as pursued recently, should clearly be on the political agenda of the transition countries, even according to the orthodox economic doctrine. According to the orthodox view, reform of labour legislation should be also considered. However, this should be done while considering and combining the whole set of labour market institutions, in order to find a proper balance between the need of flexibility, as desired by employers and the need of security, as desired by workers.²⁹

As this analysis was focused very much on aggregate labour market outcomes, such as unemployment levels and labour input, it is important to research the adjustment of labour markets to the macroeconomic and structural reforms that have taken place in these countries, as there have been many changes in this respect over the last decade (i.e. research labour market dynamics). According to Gabrisch and Buscher (2005 p. 17) unemployment rate responds in the transition countries to changes in output since the late 1990s, which gives,

²⁸ One of possible explanations of this phenomenon is linked to high level of unemployment in those transition countries, so in order to balance the budget (or reduce the budget deficit) governments are tempted to increase the burden of taxation on existing workers.

²⁹ It should be also noted that higher job security induces workers to spend more, and thus generates higher aggregate demand, that is beneficial to the whole society, including the employers.

according to them, evidence for completed transition. As orthodox economists, Gabrisch and Buscher have problems with persistently high unemployment rates in Poland and Slovakia, so they classify those countries as “exceptions”, despite the fact, that Poland is the largest of new EU members. They blame high level of unemployment in other transition countries and regions, such as East Germany³⁰ on “the level of unemployment inherited from earlier transition shocks”. Their advice is, again, very orthodox: “one option is to increase flexibility on the labour markets (increase of the Okun coefficient³¹), the other one is to support output growth at a path higher than until now.” Obviously, supporting growth of output is a rather difficult task, especially in capital-deficient economies, such as post-transition Polish economy, politicians are tempted to increase flexibility of labour market by removing more and more rights from the workers and limiting, already very low, unemployment benefits.

On the other hand Gabrisch and Buscher are right when they conclude that “one strong obstacle in reducing this stock (of unemployment – LK) is technological progress” and thus “the objective to reduce unemployment more than until now would need a growth rate of output significantly higher than productivity growth, which necessitates a higher component of aggregate demand growth. Whether a lower unemployment rate, achieved by a less restrictive fiscal and monetary policy, would entail a higher inflation rate...is a different research issue.”

Therefore, I draw a conclusion that although labour market institutions are important in controlling the level and structure of unemployment, the decisive factors are, however, definitely of macroeconomic nature. Those factors are namely:

- the general condition of economy, especially:
 - the size of aggregate demand and
 - conditions on foreign markets.

General condition of economy, especially the size and structure of aggregate demand is an obvious factor affecting unemployment, so it does not demand further explanation in this place. As to the foreign markets: they *on the one hand* influence (frequently in a positive way) demand for the exports, but *on the other hand* can reduce domestic employment by encouraging imports of good and services that replace goods and services produced internally, as it can be observed especially in case of Poland, where more than a decade of restrictive monetary policies (aimed mostly in sustaining low level of inflation) and consistent policy of overvalued currency are the major factors explaining exceptionally high level of unemployment in this country since year 1990.

³⁰ Although not mentioned by them by the name (obviously for mostly political reasons), persistently high unemployment rates in former GDR prove failure of economic transition in this country.

³¹ Okun coefficient links unemployment changes to output changes and is related to so-called Okun’s law that was named after American economist Arthur Okun (1926-1980), and states that “the elasticity of the ratio of actual to potential output, with regard to a change in the employment rate, is a constant of roughly three” (<http://www.economyprofessor.com/economictheories/okuns-law.php> as on 7/12/2006). Okun developed his “law” in 1970 by analysing American GNP during the 1950s and 1960s and found that 1% rise in unemployment was associated there with 3% per cent decrement in the ratio of actual GNP to full capacity GNP (Okun, 1970). This is clearly empirical law, of limited use as it refers only to a given economy at a given period, as similar “law” that was “discovered” by Phillips. The Phillips curve that shows relation of inflation to unemployment in the UK in years 1861 to 1967, i.e. before the period of stagflation in the 1970s (Phillips, 1958).

Annex I. Methodological note on EPL indicators using OECD methodology

The OECD has produced several EPL (employment protection legislation) indicators to study the relationship between EPL and labour market flexibility and its outcomes. In 1999 these indicators have been updated and have been enlarged to consider regulation concerning collective dismissals. The methodology describes here corresponds to this recent version of the EPL indicators. The summary indicator presented in this paper (table 3, last column) is constructed as a weighted average of 22 different measures describing various aspects of the legislation, covering both permanent and temporary contracts, as well as collective dismissals. Some of these measures are available as such based on normative information (e.g. notice period, maximum duration of temporary contracts, etc.), but some others need to be transformed into quantitative terms, using a subjective (arbitrary) conversion scale, which is (without any doubt) a main weakness of this methodology. Details are in Cazes (2002 pp. 29-30).

In short: there are 22 indicators aggregated in three steps, from one level to the next using a set of weights. The first level refers to updated information (1999-2000), which was collected by national experts - details for Bulgaria, Estonia, the Czech Republic, Poland and the Russian Federation in Cazes & Nesporova (2002). Several sub-indicators are then obtained referring to major components of the legislation such as procedural inconveniences, notice and severance pay for no-fault individual dismissals, or the difficulty of dismissals (level 2). Level 3 provides three groups of indicators:

1. One describing legislation for regular contracts;
2. One covering temporary contracts and
3. Capturing the collective dismissals procedures.

In a final step, these three sub-indicators may also be aggregated in an “overall summary indicator” using different, arbitrary weights. The countries with very flexible employment regulation have thus a low overall EPL indicator (close to 0 or 1), while those with very strict legislation will have a high indicator (close to 5 or 6). Again, it must be remembered that as conversion scale is highly arbitrary, so the results must be biased.

Annex II. Registered unemployment: data sources

Country	Unemployment rate - ration of	Changes of methodology	Source	Comments
Czech Republic	Job applicants to the sum of economically active incl. women on additional maternity leave	From July 2004 calculated with a share of disposable number of registered unemployed persons	Czech Statistical Office	
Estonia	Registered unemployed as per cent of population aged 16 to pension age		Estonian Statistical Office	
Hungary	Unemployed to total labour force	From May 1995 methodological changes	Central Statistical office	From January 2000 calculated because no data officially published
Latvia	Persons registered with the State Employment Agency as unemployed to the		Central Statistical office	

	number of economically active population			
Lithuania	Registered unemployed persons to the working age population		Central Statistical office	
Poland	Unemployed to civilian population of economically active	Since January 2002 revised to census 2002	Central Statistical office	
Slovakia	Unemployed to the economically active population	From December 1997: share of disposable number of registered unemployed to the economically active persons of the previous year	Slovak Statistical Office	From 1 August 2000 new law on unemployment benefits
Slovenia	Unemployed to the economically active population		Bank of Slovenia	

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