Marta Sordyl
Department of Macroeconomics
The Krakow University of Economics

NEW ASPECTS OF LABOUR MARKET REGULATIONS IN EUROPE

Abstract

According to the view that has dominated – until quite recently – labor market analyses, the maine source of troubles with high unemployment in Europe were wrongly constructed institutions, understood as a mix of regulations, taxes and subsidies that affect relations between firms and workers. It was widely believed that labor market deregulation accompanied by correctly executed institutional reforms would allow to radically reduce the unemployment and, in turn, increase the economic growth.

Recent research takes different attitude towards labor market institutions; they are seen as means to accelerate economic adjustments and to avoid aconomic crises, as well as to improve income allocation without weakening the efficiency.

This paper presents, in its first part, the evolution of theories that have been trying to explain the phenomenon of European unemployment. Second part focuses on the ongoing debate on the empirical support for different theoretical positions. Finally, it shows labor market institutions as a component of social as well as economic environment, being subject to complex and sometimes radical changes.

Introductory remarks

European unemployment started increasing in the 1970s and increased further during the 1980s. Towards the end of the 20th century it reached a rough plateau accompanied by a trend to diversify across countries. Over the past thirty years several theories attempted to explain this phenomenon, neither of them providing full and satisfactory explanation. It was initially believed that the reasons for this development were external shocks; however, as the economies stabilized and the unemployment rates remained high, the focus shifted to labor market institutions. Still, the question whether labor market institutions are really the culprit, and, more importantly, how they should be shaped in order to promote employment, remains unanswered.

This paper presents, in its first part, the evolution of theories that have been trying to explain the phenomenon of European unemployment. Second part focuses on the ongoing debate on the empirical support for different theoretical positions. Finally, it shows labor market institutions as a component of social as well as economic environment, being subject to complex and sometimes radical changes.

The causes of Euroean unemployment – evolution of ideas

The development of the unemployment rate in the EU15 (the 15 European Union member countries before the enlargement, treated as a whole) shows steady increase from 2 percent in the 1960s to 8 percent in the 1980s; since then it becomes roughly constatnt with only cyclical changes (Blanchard, 2005). The first important question is, how much of that change can be explained by an increase of the actual unemployment above the natural rate, and how much represents the change in the natural rate itself.

If we assume that constant inflation rate (as it has been in the EU15 in the last few years at the 2 percent level) indicates unemployment roughly equal to the natural rate, it would mean that the increase in the European unemployment is caused mainly by an increase in the natural rate. If this second phenomenon indeed had occured, the second question is, what were the reasons for the increase – external shocks, macroeconomic policy, changes in labor market institutions or some other factors.

In the 1970s European countries experienced a series of adverse shocks starging with two major oil price increases in 1973-74 and 1979. Initially less visible, but eventually more important, was a slowdown in the total factor productivity growth. It declined from 5 percent in the 1950s and 60s to only 2 percent in the 1970s (Blanchard, 2005). Nominal and real wage rigidities contributed to transition of shocks into high – and diversified – unemployment rates[1].

The differences in unemployment patterns between European countries were at first explained by the country-specific construction of collective bargaining. "... in the face of adverse supply shocks, countries with either very centralized bargaining or very decentralized bargaining would fare better than those with intermediate bargaining structures. With centralized bargaining in particular, the parties at the bargaining table could see the need for and implement the wage adjustment required to maintain employment" (Blanchard, 2005, p. 13). This argument has found some empirical support, yet it could hardly provide full explanation of either the unusually high uneployment levels or the differences between countries.

European unemployment continued to rise during the 1980s from 5 percent in 1980 to 8 percent a decade later, with a peak at 9,5 percent in 1986. The increase in the unemployment rate in early 1980s was relatively easy to explain: The governments were trying to bring down inflation caused by the use of accomodating monetary policy in response to adverse supply shocks. The EU15 inflation rate reached 12,5 percent in 1980 and was reduced to 3 percent in 1986 (Blanchard, 2005). In this situation the unemployment growth reflected an increase of the actual rate over the natural rate. However, for the rest of the decade the inflation rate remained stable, so that the actual unemployment rate of 8-9 percent should be roughly equal to the natural rate. This could hardly be explained by shocks that had occured almost a decade earlier.

Other explanations were needed. One of them was offered by (Layard, Nickell, 1987). The authors focused on the impact of high and long-lasting unemployment on human capital. Arithmetically, there can be two sources of high unemployment: high inflows into or high average duration of unemployment. The second factor constitutes the main difference between unemployment in Europe and in the US. The average duration of unemployment spell in Europe has grown along with the unemployment rate during the last decade of the 20th century, while in the US it has kept the lenght of about three months. The more prolonged the duration of unemployment, the more severe consequences in terms of lost skills and practical knowledge. Many of long-term unemployed become in fact unemployable[2].

So one important difference between European and the US labor market is the scale of reallocation. Even if unemployment rates are similar, flows are lower in Europe. This clearly impedes the firms' ability to smoothly adjust their labor force to temporary shocks. It also means that workers and jobs are less efficiently matched: more workers stay in jobs they find inappropriate for themselves or are inappriopriate for, as well as more firms keep workers they are not satisfied with (Blanchard, 2002).

[1] For details, see (Blanchard, 2005, pp. 12 n).

[2] In general, high unemployment is strongly associated with low labor force participation rates. It suggests that the unemployed in countries with long unemployment spell often decide to leave the labor force, especially when they can receive generous disability benefits or early retirement.

If unemployment rates are similar and flows are lower, the average unemployment duration must be longer in Europe than in the US, which is indeed the case. The average unemployment spell lasts 3 months in the US and close to one year in Europe. "A long unemployment spell is much more likely to lead to a loss of skills, a loss of hope and self confidence; indeed these effects have been well documented in Europe. Here different labor market institutions look very much like a potential culprit" (Blanchard, 2002, p. 5).

European unemployment remained at very high levels during the 1990s, with a peak at 10,4 percent in 1993 and a decline to 8,6 percent in mid 2005. The average EU15 rate, however, does not provide stisfactory information. In fact, the mere term "European unemployment" can be misleading; unemployment patterns across the EU15 countries are heterogenous. In some of these countries (United Kingdom, the Nederlands, Denmark, Ireland) unemployment rates are actually lower than in the US. High average European unemployment reflects high unemployment rates in large continental countries: Germany, France, Italy and Spain, which in turn show significant differences between themselves.

Different reactions to common shocks across European countries, as well as the persistence of high unemployment in some of them, could be explained by disparate sets of labor market institutions. The first analysis adopting the new theory (or the so called new orthodoxy) was the 1994 OECD Jobs Study (OECD, 1994). The Study identified ill-adapted institutions, which lead to labor market rigidities, as the main source of high unemployment in Europe. The report turned out to be very influenatial not only among scholars, but policy makers as well. However, as it will be shown later in the paper, it was not conclusive.

The most recent research concentrates on potential interactions between institutions and shocks[3]. One of the hypotheses explains the role of institutions in the context of changes in the economic environment. Lowering trade barriers, increasing competition in the goods markets, globalization and integration of markets across national borders would make the existing labor market institutions disfunctional and thus leading to higher unemployment levels. "Employment protection, which was rarely binding before as firms rarely laid off workers, becomes binding and increases the cost of firms. Unemployment benefits, which were not very costly so long as few workers were laid off, become costly, requiring higher contributions and leading again to higher costs of firms. The general story is appealing... There is only one catch, however. We may all believe it, but the data just do not show it..." (Blanchard, 2005, p.27). As it seems, the allegedly increased turbulences, measured by standard deviation of rates of change of employment across sectors or regions in fact did not alter significantly[4] .

Another frequently mentioned cause of the persistence of European unemployment is excessively stringent monetary policy. The EBC is sometimes criticized for its passive behaviour in the context of the unemployment or more widely low economic activity. The institution remains focused on the inflation rate; stable inflation indicates that unemployment is close to its natural rate. But lowering the natural rate can only be achieved by labor market reforms, which are not, of course, the responsibility of the central bank[5].

[3] See for example (Daveri, Tabellini, 2000), (Bertola, Rogerson, 1997).

[4] For a summary see (Layard, Johnson, 1986)

[5] This assumption may be however put under question when inflation rate is low, which is the case in the EU15. In this environment nominal rigidities are more important as the workers may be reluctant to accept nominal wage cuts. If it is so, demand expansion triggered by monetary factors might in fact lead to a decrease in unemployment without accelerating price increases. A decrease in unemployment might in turn faciliate labor market reforms, thus decreasing the natural rate (Blanchard, 2005). On the other hand, lower unemployment might impede reforms, if the policy makers lack determination to take unpopular decisions and feel no need to make them when the unemployment decreases.

Empirical evidence

"In the thrilling days of yesteryear, economists believed that the key to economic performance was macro-economic policy. Monetarists argued that appropriate monetary policies were the magic bullet for price stability and curbing the business cycle. Keynesians favored fiscal policy: deficits to speed economic recovery and surpluses to reduce inflationary pressures. Today, there is a new orthodoxy that makes the deregulation of labor market institutions and increased employment and wage flexibility in the labor market the keys to economic success" (Freeman, 2005, p. 1).

The initial increase in European unemployment caused substantial changes in labor market institutions. It was assuemd that shocks, as well as their consequences in form of higher unemployment rates, were only temporary, therefore the employment protection was sharply increased and unemployment insurance made more generous. Those changes were ment to limit the short-term impact of shocks. However, as high unemployment persisted, the measures mentioned above proved to be incorrect for at least two reasons: First, the unemployment benefit system was put under strong financial pressure, especially hard to bear during the economic slowdown. Second, it turned out that new institutions aggravated rather than diminished labor market inefficiency, affecting both supply and demand side of the market: Costs for firms rose along with workers' reservation wages.

In retrospect it seems clear that many of the reforms undertaken in 1970s and early 1980s have had perverse effects. Some of them were poorly designed, without proper view of possible consequences; other suffered from political or social constraints. The reversal of institutional changes did not take form of simply returning to previous patterns. The workers' protection was reduced mostly by introducing new types of labor contracts – temporary, and thus less protected than traditional permanent contracts. "Whether such a reform actually decreases unemployment is ambiguous; what is certain is that it has created a dual labor market, with protected and marginal workers" (Blanchard, 2005, p. 30).

It is widely believed that labor market rigidities: generous unemployment insurance schemes, high employment protection, high minimum wages noncompetitive wage setting mechanisms and severe tax distortions are to blame for high unemployment rates and slow economic growth. International agencies, such as the OECD and the IMF, recommend labor market deregulation as the best way to promote employment and increase efficiency. Weakening institutions in favor of market forces is not only theoretically accepted, but also put in practice in some countries.

On the research side, new assumptions were supplemented by a new framework based on flows in and out of unemployment, matching process between workers and firms, and wage bargaining. This allowed to construct more complex models of labor market, including both micro and macro data, providing new tools to analyse observed facts and search for the sources of unemployment. The results seemed to prove that heavy regulation in the labor market impeded economic growth and created unemployment. After analysing more than 80 countries (Botero, et al., 2003) concluded that "... richer countries regulate labor less than poorer countries do, although they have more generous social security systems... Heavier regulation of labor is associated with a larger unofficial economy, lower labor force participation, and higher unemployment, especially of the young" (p. 1).

However, the evidence in support of the new orthodoxy thesis is not straightforward. After a decade of extensive empirical research economists still have not reached agreement on the consequences of labor market institutions and potential effects of deregulation. There are at least two factors responsible for the lack of conclusion in this debate (Freeman, 2005). First, the proponents of labor market deregulation hold strong priors that labor market would operate perfectly – or at least much more efficiently – in the absence of institutions, and the

priors influence the way in which they analyse and interprete empirical results. Second, cross-country data are insufficient to reach final conclusions, supporting or eliminating the new orthodoxy thesis. Critical labor market analysts argue that the models supposedly justifying deregulation are non-robust and ill-specified. The empirical results, however, are mixed. "Differences in institutions appeared able to explain much of the differences in unemployment rates *across countries* either in the 1980s or in the 1990s. ... Changes in institutions did not appear able, however, to explain the evolution of unemployment rates *over time*"[6].

Labor market institutions as the main cause of high unemployment were first proposed in the already mentioned (OECD, 1994). The Study listed ten recommendation to reduce unemployment and promote economic growth. Apart from strong macro-economic policy, technical and educational progress and enhanced product market competition, it called for labor market reforms: increased flexibility of working time and wages, lowering non-wage labor costs for firms, reforming social security provisions as well as unemployment benefit systems. The Study also recommended active labor market policies [ALMPs] – training programms, job-finding assistance, subsidies for firms hiring long term unemployed or disabled workers.

According to the IMF, labor market deregulation should lead to radical fall in European unemployment, even below the US levels: "... labor reforms could produce output gains of about 5 percent and fall in the unemployment rate of about 3 percentage points... those benefits could be doubled by simultaneous efforts to increase competition in the product market" (IMF, 2003, p. 129). Both the IMF and the World Bank recommended labor market reforms as means to strenghten macro-economic stabilization and structural adjustment in developing countries. Deregulation and enhanced competitiveness were included in most of the reform packages implemented as part of economic programmes supported by these institutions.

Labor market rigidities were marked as culprits of economic crises. Michael Mussa, former chief economist at the IMF, commenting on the 2002 economic collapse of Argentina, wrote: "If Argentina had a more flexible economic system, especially in its labor market, its economy would have been more able to adapt to the rigors of the convertibility plan, unemployment would have been lower, growth would have been stronger, fiscal deficits would have been smaller, and interest rates would have been lower" (Mussa, 2002, p. 9). In other words, there would be no crisis or at least the crisis would be much less severe than it had actually been.

There is, however, another side of the picture. Some economists, as well as some international agencies, see labor market institutions as a means to enhance economic edjustments and avoid macro crises (Freeman, 2005). For example, collective bargaining systems centralized at the national level may faciliate adjustments if bargainers have better knowledge and take into account macro-economic situation, as in the Nordic model[7].

Also the International Labor Organization (ILO) supports the assumption that proper institutions could improve income redistribution and foster economic progress without efficiency losses (Freeman, 2005).

In the last few years the World Bank has significantly changed its attitude towards labor market institutions. In 1995 the World Development Report (World Bank, 1995, p. 86) it merely stated: "It is possible to identify conditions and policies under which free trade unions can advance rather than impede development". By 2003 it went much further, pronouncing that "At the macroeconomic level, high unionization rates lead to lower inequality of earnings and can improve economic performance (in the form of lower

---

[6] (Blanchard, 2005, p.21); emphasis as in the original text. See also (Blanchard, Wolfers, 2000).

[7] See for example (Milner, Wadensjö, 2001), (Holmlund, Zetterberg, 1991).

unemployment, inflation, higher productivity and speedier adjustment to shocks)" (World Bank, 2003). Similar views are represented by InterAmerican Development Bank: "Labor regulations are not cost-free, but deregulation is not the answer" (InterAmerican Development Bank, 2003, p. 7).

Both sides of the debate quote the empirical evidence to support their arguments. There are many empirical studies trying to assess the impact of institutions on unemployment rates by comparing outcomes between countries with different sets of institutions or in the same country before and after an institutional change. Initional research seemed to strenghten the point that institutions were indeed the main cause of European unemployment. Such results, first presented in (OECD, 1994), were followed by other authors, for example (Layard, et al., 1994), (Nickell, 1997).

"But these analyses are akin to prosecutor's case in trial. They give the evidence that suggests the institutions are guilty, but do not reflect on the weaknesses of that evidence. To reach a verdict, it is necessary as well to see the arguments by analysts who take the other side of the debate – the defence attorneys, as it were. These researchers give a different reading of what the data shows and, most important, of the robustness of the case against labor institutions" (Freeman, 2005, p. 9).

Estimations of models used to prove the negative impact of institutions seem sensitive to changes in the measures of institutions, countries or time periods covered[8]. According to (Blanchflower, 2001), there is "only a weak positive relation in the OECD between unemployment and benefits" and "no support... for the belief that unions, benefits, the tax wedge, ALMP spending or earnings dispersion influence unemployment"[9].

It seems that the same sets of data appear absolutely convincing to the adherents of the new orthodoxy and in the same time – inconclusive to their critics. One of possible explanations is the formerly mentioned strong prior held by many economists that all markets, including labor market, would work better without any intervention – unless proven otherwise. Thus, if the market does not work properly, as it is the case in high unemployment countries, it must be caused by institutions that impede the operation of market forces. If, for example, the European countries have different institutions than the US and also higher unemployment rates, so the institutions must be the reason for differences in unemployment patterns. This prior determines specification of models and interpretation of empirical results.

If one truly believes that labor market institutions increase unemployment, one tends to discard results that do not fit the theory; one is rather inclined to suspect that the model is poorly specified or that data sets are incomplete or random observations weight too heavily on end results... In short, one is inclined to ignore the results not fitting the theory rather than to question the theory itself. On the other hand, if one gets results confirming one's priors, there is no need to look further for potential weaknesses.

Looking for weaknesses is exactly what the opponents do. Their task is easier, as all they have to do is prove the institutions innocent; they do not need to find another suspect. Still, even if we put the priors aside, it is hard to precisely assess the impact of institutions on unemployment. First, the great number of possible configuration of institutions across countries makes it impossible to gather all the needed observations. Furthermore, institutions in advanced countries were mostly shaped by common – or at least similar – social, historical and political factors, they may be thus highly correlated. If we take into consideration changes in institutions over time, it becomes clear that the number of possible configurations exceeds the number of independent data sets[10].

---

[8] See (Baker, et al.,2004)

[9] Quotations, respectively, p. 390 and 392.

[10] It should be mentioned, however, that some institutions indeed have ambiguous consequences. For example, high employment protection may discourage firms from hiring workers, thus contributing to higer

There is one point, however, on which both adherents and opponents of the new orthodoxy seem to agree: Labor institutions increase equality of pay in comparison to competitive markets, at least in advanced economies (Freeman, 2005). The evidence is plentiful. The dispersion of earnings is lower in unionized secors than in nonunion sectors; across countries it is lower for countries with higher rates of collective bargaining coverage. Moreover, dispersion decreases over time when institutions in a given country play a greater role in wage setting. To sum up, as far as the data show, institutions promote earnings equality, but their impact on other variables, such as employment and unemployment rates, is ambiguous.

Labor market institutions for the new economy

The popular view is that "Western Europe suffers from too many labor market rigidities, from excessively generous unemployment insurance to high employment protection, and to high minimum wages" (Blanchard, 2002, p. 1). It does not mean, however, that simply reversing this situation would be the best solution. Labor market cannot function properly without institutions; they are not, by nature, perfectly competitive. Regulations are supposed to balance some market failures, caused by imperfect information and uneven distribution of market power between different groups of actors. The firms find it difficult to fully monitor the workers' skills or their efforts, as well as the workers cannot properly evaluate their contribution to the firm's productivity, and, therefore, the wages they deserve. If employers dominate the labor market, wages may be pushed too low; if employees have strong position, wages can be too high. And finally, market mechanisms do not provide full insurance against unemployment, especially at the lower wage end.

Labor market institutions, as we see them today, are the product of prolonged evolutionary process, shaped by different economic, political and social developments. It does not imply that they are optimal; they clearly are not. Even then their adverse effects are not easy to identify. In spite of – as it is widely believed – far less employment friendly institutions, some European countries match the US labor productivity levels (Blanchard, 2002). High average unemployment rate in the EU15 hides significant diversity across countries. Yet most of them have similar, "European style" labor market institutions.

The most frequently analysed institutions are unemployment benefits, tax wedge and collective bargaining. Extensive research at micro and macro level led to general consensus on some important points. It is essential for modern economies to constantly reallocate their resources in order to increase efficiency. As far as labor is concerned, workers value security and tend to insure themselves against adverse developments, especially job loss. The trade-off between efficiency and security may be decreased by properly adjusted institutions. The main issue is to effectively protect workers, not jobs. Thus, unemployment insurance should be fairly generous, but conditional, depending on the person's willingness to train for and take up new job if available. Employment protection should take form of financial costs to firms for laying off workers to make them internalize social costs of unemployment, including unemployment insurance, rather than complex administrative and judical measures. The need to decrease the cost of low skilled labor should be fulfilled by lower social contributions paid by firms at the low wage end, and the need to make work attractive to low skilled workers – by negative income tax rather than a minimum wage (Blanchard, 2005).

The presented reforms are undoubtedly desirable; the question is, however, whether they are enough to deal with European unemployment. One unexplored, so far, area is collective bargaining. Countries with relatively low unemployment rates, such as Sweden or

---

unemployment. On the other hand, it may reduce short-term unemployment, as lay-offs become more costly.

Danemark, differ in this regard from, say, Italy or France. It is not certain, whether lowering unemployment rates in those countries would require changes in their collective bargaining systems. Even if they were changed accordingly to Scandinavian patterns, it cannot be taken for sure that it would lead to similar decrease in unemployment.

Post-war welfare states were built on the twin assumptions that do not seem to be binding anymore, namely the assumptions of full-time, mostly male employment and stable families. The so called male breadwinner model was undermined by demographic, social and economic changes. Labor laws, more often than not, are unable to keep pace with these changes. The traditional model has not yet been replaced by some other fully developed model of employment, although there are some signs that we are moving towards an individualised adult worker model or an one and a half earner model . Both employment and social insurance need to adapt to more diverse labor force and more complex family structures. To solve the problem of less secure employment, we have to break the link between social security and employment relationships in their traditional form.

A few years ago the European Commission invited a group of experts – lawyers and economists – chaired by Alain Supiot, to take a closer look at the labor law reform. Their analyses took form of the "Supiot Report" (Supiot, 2001). The report concentrated on the nature of the employment relationships rather than on individual protective measures, trying to capture the risks and chances stemming from the changes in the modern economic environment.

Nowadays firms are in need of greater flexibility to enable them to respond to technical and organizational progress, as well as increasing international competition. They also have to take into account changes that occur in households and societies. New institutional framework for employment should be compatible with more fluid employment relationships and shorter average duration of jobs (Marsden, 2001). Every contractual framework consists of labor institutions. They should be shaped in order to provide both firms and workers with conditions to cooperate and share risks as well as profits. The employment relationship enables both parties to develop stable and flexible relations despite their diverging interests and despite the often limited trust between them. It constraints the agents in their mutual relations in order to create certain level of predictability. In short, "institutions constrain in order to enable" (Marsden, 2001, p. 2). That is what they were constructed for.

This truth have been obscured by the ongoing debate in which "free markets" are contrasted with "institutional rigidities", supposedly obstructing the operation of market forces and, thus, causing efficiency losses. In fact,over decades the employment relationship proved to be beneficial for both firms and workers.

The Supiot report makes three fundamental observations (Marsden, 2001, p.3):

- the employment relationship in its existing form has reached its limits as many firms need more flexible relationships with their employees than it can currently provide;
- minor modifications in form of special types of employment contracts for different categories of workers has diluted protection without increasing the number of new jobs; and
- reform of the employment relationship poses severe problems for labor law, collective bargaining and social insurance, because they have been all based on the standard employment relationship.

The needs of firms have changed; new employment relationship should accomodate new and more flexible organization patterns. On the other hand, workers seek protection that they do not find in "self-employment" or in different forms of non-standard, fixed-term or specific task contracts. Workers protection in form of labor laws and collective bargaining was supposedly bought at a too high price. Protecting those in employment made things worse for the unemployed. After more than a decade of labor market deregulation in some countries, the OECD analysts concluded, however, that the evidence as to wheather

employment protection actually forced firms to reduce their labor force was uncelar (OECD, 1999).

The contract of employment is relatively recent institution. It evolved from the master/servant model and owns its existence to the welfare state. At first it was seen as a means for dealing with risk allocation. Today it covers, apart from employment relationship itself, some other issues, such as social insurance systems, a pay-as-you-earn tax system and employment protection. These means build a mechanism to shift risks. In a word, the central point of the employment contract is the bargain of security in return for subordination. It is possible that solving the European unemployment problem would require changing the nature of the employment contract itself. The problem is, how to calibrate the mechanism to obtain results acceptable for both sides of the contract.

In modern views employment is defined by comparison with other types of activities, mostly unpaid work, training and self-employment. These distinctions, however, are becoming increasingly blurred. Training can be part of employment contract; new technologies erode the borderline between employment and private life.

The question is how to shape the new types of employment and how to make sure that they are not becoming unnecessairly precarious. Fixed-term contracts demand solving the structural problem of how to combine the limited duration of employment with the much longer working life of the person involved. It is not just about a reduction in the working week; we have to look at the working hours issue much more broadly, in the context of the person's whole working life, including different forms of paid leave, early retirement, further training etc. Three important problems in this area remain unsolved. First, we need to compensate for the unpaid care work that all societies find necessary. Second, we have to promote smooth transition between different types of paid and unpaid work in the person's life course. And third, we have to provide some kind of guarantees for workers who enter low paid, flexible jobs, that they receive proper compensation.

Concluding remarks

The debate on the impact of labor market institutions on employment and unemployment levels in Europe remains inconclusive. Recent research does not provide clear support for the new orthodoxy, nor does it prove it absolutely wrong. Deregulation of labor market itself cannot solve all its problems. Existing labor market institutions are obviously not optimal: empirical evidence shows that they increase costs for firms, reduce efficiency and negatively affect resource allocation without visibly improving welfare. But optimistic views, widely acknowledged a few years ago, that simply deregulating labor markets would solve the European unemployment problem, have failed to materialize. It seems that labor market insititutions are not the culprit after all – at least not the only one.

The problems of labor markets – employment levels as well as unemployment rates – must be seen in a wider context. Organisational changes in the economy resulted in changes in job tenure and growing job insecurity for marginal workers: part-time workers or self-employed. The entire system needs to adjust to greater diversity in the labor market and to growing levels of discontinuous and multiple employment. The real challenge for the nearest future will be to match people's working time preferences with the avaliable opportunities and to devise a social security system that enables people to make those choices through their working lives. The basic – and so far unanswered – question is how it could be done in such a way that it contributes to the creation of more employment.

REFERENCES:

1. Baker D., Glyn A., Howell D., Smith J., (2004), Labor Market Institutions and Unemployment, in: Questioning Liberalization: Unemployment, Labor Markets, and the Welfare State, ed. D. Howell, Oxford University Press.
2. Berger H., Danninger S., (2005), Labor and Product Market Deregulation: Partial, Sequential, or Simultaneous Reform? IMF Working Paper No. WP/05/227, December.
3. Bertola G., Rogerson R., (1997), Institutions and labor reallocation, European Economic Review, No. 41 (6), pp. 1147-1161.
4. Blanchard O., (2005), European unemployment: The evolution of facts and ideas, NBER Working Paper No. 11750, November.
5. Blanchard O., (2002), Designing labor market institutions. Remarks at the Conference Beyond Transition, Warsaw.
6. Blanchard O., Wolfers J., (2000), Shocks and institutions and the rise of European unemployment. The aggregate evidence, Economic Journal, vol. 100 (1), pp. 1-33.
7. Blanchflower D., (2001), Unemployment, Well-Being, and Wage Curves in Eastern and Central Europe, Journal of the Japanese and International Economies, vol. 15, pp. 364-402.
8. Botero J., Djankov S., La Porta R., Lopez-de-Silanez F., Shliefer A., (2003), The regulation of labor, NBER Working Paper No. 9756, June.
9. Daveri F., Tabellini G., (2000), Unemployment growth and taxation in industrial countries, Economic Policy, April, pp. 47-104.
10. Estevão M., (2003), Do Active Labor Market Policies Increase Employment?, IMF Working Paper No. WP/03/234, December.
11. Freeman R. B., (2005), Labor market institutions without blinders: The debate over flexibility and labor market performance, NBER Working Paper No. 11286, April.
12. Holmlund B., Zetterberg J., (1991), Insider Effects in Wage Determination: Evidence from Five Countries, European Economic Review, July.
13. IMF, (2003), Unemployment and Labor Market Institutions: Why Reforms Pay Off, in: World Economic Outlook, IMF, Washington DC.
14. InterAmerican Development Bank, (2003), Good Jobs Wanted, Baltimore, MD: John Hopkins Press.
15. Layard R., Johnson G., (1986), The natural rate of unemployment: Explanation and Policy, in: Handbook of Labor Economics, Vol. II, ed. O. Ashenfelter, R. Layard, North Holland.
16. Layard R., Nickell S., Jackman R., (1994), The Unemployment Crisis, Oxford University Press.
17. Layard R., Nickell S., (1987), The labor market, in: The Performance of the British Economy, ed. R. Dornbusch, R. Layard, Clarendon Press, Oxford.
18. Marsden D., (2001), Can the Right Employment Institutions Create Jobs?, in: D. Marsden, H. Stephenson (ed.), Labor Law and Social Insurance in the New Economy: A Debate on the Supiot Report, Centre for Economic Performance, London.
19. Milner H., Wadensjö E., (2001), Göösta Rehn, the Swedish Model and Labor Market Policies, International and National Perspectives, Ashgate.
20. Mussa M., (2002), Argentina and the Fund: From Thriumph to Tragedy, Policy Analyses in International Economics, vol. 67, Institute for International Economics, July.
21. Nickell S., (1997), Unemployment and Labor Market Rigidities: Europe versus North America, Journal of Economic Perspectives, vol. 11 (3), pp. 55-74.
22. OECD, (1999), Employment Outlook 1999, Paris.
23. OECD, (1994), The OECD Jobs Study – Facts, Analysis, Strategies, OECD Publishing.

24. Supiot A., (2001), Beyond Employment. Changes in Work and the Future of Labor Law in Europe, Oxford University Press.
25. World Bank, (2003), Economies Perform Better in Coordinated Labor Markets, Press Release No. 2003/211/S.
26. World Bank, (1995), World Development Report: Workers in an Integrating World, Oxford University Press.