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Labour market transitions, cross-country differences and institutions during the crisis in Europe

The global economic and financial crisis has led to a strong and persistent increase in unemployment in many European countries. At the same time, the labour market evolution of the different European countries has been very diverse, both with respect to the increase in unemployment, as well as to the persistence of unemployment. Although there has been some research on this topic, (e.g. Elsby et al., 2013; ECB, 2012), a clear assessment of labour market reactions to the crisis and the role of institutions still remains elusive.

The aim of this paper is therefore to provide a detailed analysis of the labour market experience in Europe during and after the Great Recession, focusing on cross-country differences and the importance of institutions in this context. In order to do so, we use data from the European Union Survey on Income and Living Conditions (EU-SILC) and proceed as follows. First, we compute descriptive evidence on labour market transitions, focusing in particular on the rates at which employed workers become unemployed, and at which unemployed workers find a job, as well as transitions to and from temporary employment. We do so for virtually all EU countries. Second, we perform detailed cross-country comparisons, taking into account differences in GDP growth rates and in labour-market institutions. This allows us to examine the importance in differences in the performance of the aggregate economy, as well as the institutional settings of the labour market, for the reactions of the European labour markets to the crisis.

We perform the cross-country comparisons in two ways. First, to uncover the link between the probability of making a certain labour market transition (e.g. from employment to unemployment) on the one hand, and the institutional settings on the other hand, we run regressions for the transition probabilities at the individual level for all the countries in our sample, and extract the country fixed effects from these regressions. This yields estimates of our variables of interest at the country level which are adjusted for the composition of the population (age structure, education, …). Correlating these fixed effects with institutional indicators at the macro level (e.g. strictness of employment protection, union density, …) shows the link between labour market reactions and institutions at the country level. Importantly, the econometric specifications include GDP growth as an explanatory variable, i.e. the correlation between labour market transitions and institutions is not affected by cross-country differences in GDP growth. This approach yields an indication for the importance of very specific labour market institutions analysed in isolation.

Second, we perform econometric analyses separately for individual countries, taking again the transition probabilities of interest as dependent variables. We then compare the coefficients on GDP growth for countries with different institutional settings. This yields estimates of the labour market reactions for a given change in GDP (e.g. a 1 percent drop). In contrast to the first approach, this approach takes into account the entire institutional setting of a country (e.g. “flexicurity”).

The EU-SILC data set is particularly well suited for this analysis as the panel structure of the data set allows to follow individuals over time and to identify transitions between different labour market states, as well as individual and household characteristics. Given the international comparability of the data set, this makes it possible to contrast the labour market reactions across Europe taking into account composition effects, i.e. differences in labour force composition between countries.

Literature

ECB – European Central Bank (2012), Euro area labour markets and the crisis. ECB Occasional Paper Series No. 138.

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