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Did recent reforms facilitate EU labour market adjustment?

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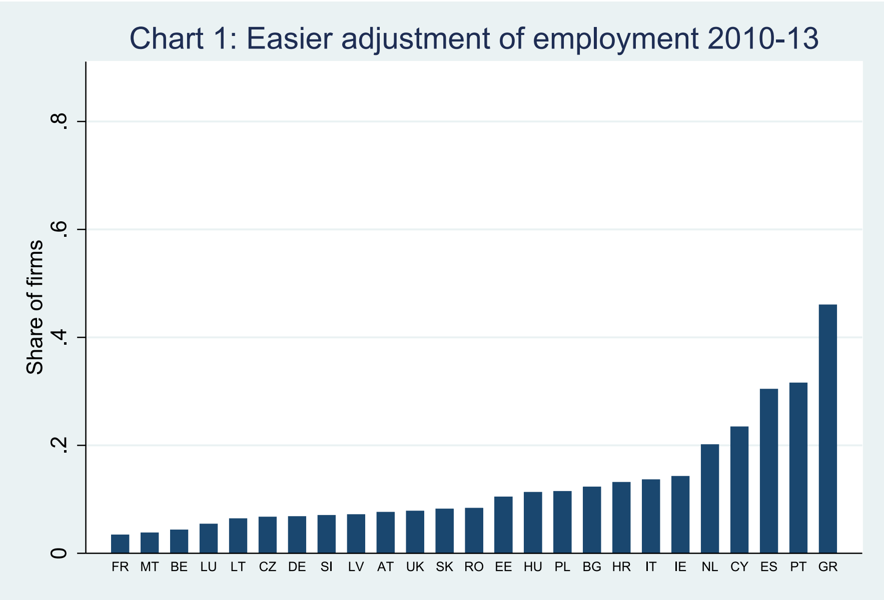
Firms in euro area countries that undertook comprehensive labour market reforms following the crisis found it easier to adjust employment and wages in 2013 than in 2010. These firms also largely attribute this easier adjustment to reforms in labour legislation.

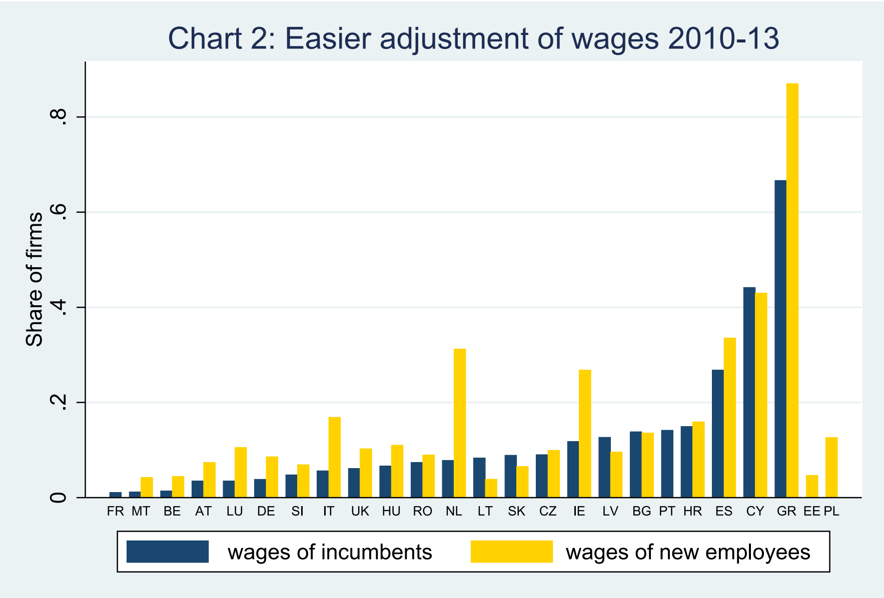
The financial crisis led some governments in EU Member States to implement a number of labour market reforms and policies designed to ensure the survival of firms by facilitating labour cost adjustment. This article presents evidence on how firms perceived these reforms. It draws on the third wave of the Wage Dynamics Network survey (WDN3), a firm-level survey that was recently conducted in 25 EU Member States and covers the period 2010-13, when the bulk of these reforms were implemented. The results of the WDN3, including those highlighted in this article, are summarised in Izquierdo *et al*. (2017).

Typically, reforms are evaluated on the basis of the underlying legislation. However, this does not provide any information either on the actual application of the legislation or on the effectiveness of reforms. The WDN3 survey overcomes this limitation as it asks firms about their actual experience with labour market reforms, making it possible to evaluate whether the changes in legislation had a noticeable impact on their ability to adjust labour costs and so giving an indication about the effectiveness of these reforms.

The survey asked firms whether it had become easier or more difficult to adjust employment via a number of channels (lay-offs, hires, changing working hours and moving workers across locations or occupations) and to adjust wages (of both incumbents and new hires) between 2010 and 2013. Chart 1 shows the percentage of firms in each country that found it easier to adjust employment in 2013 than in 2010 (it reports the average across the various adjustment channels). Chart 2 displays the percentage of firms that found it easier to adjust wages in 2013 than in 2010. These charts confirm that it was precisely in those countries where the largest and most wide-ranging labour market reforms took place (in particular Ireland, Greece, Spain, Cyprus, Portugal and Slovenia) that a substantial percentage of firms found it easier to adjust both employment and wages (and consequently labour costs) in 2013. [2]



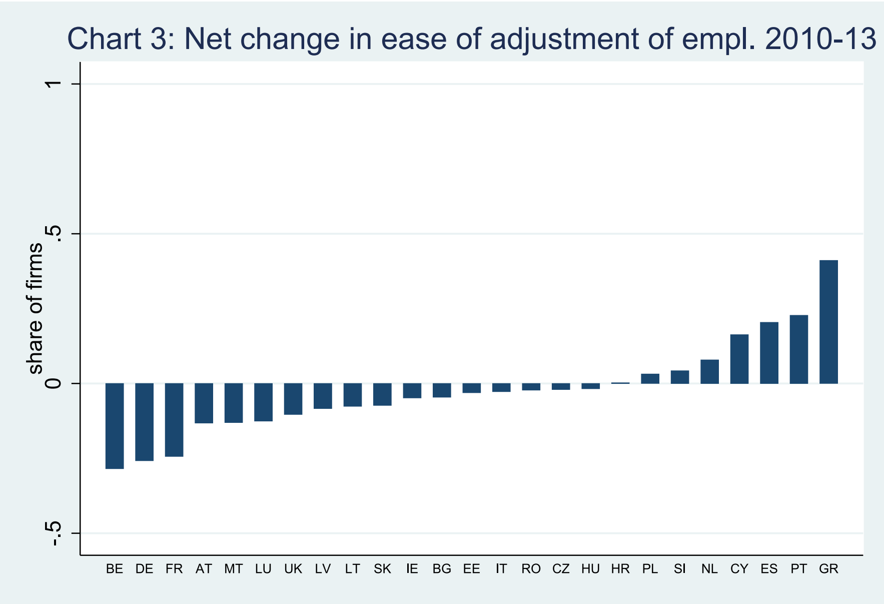
Source: Authors' calculations on the basis of the WDN3. Note: The figures are rescaled to exclude non-responses.



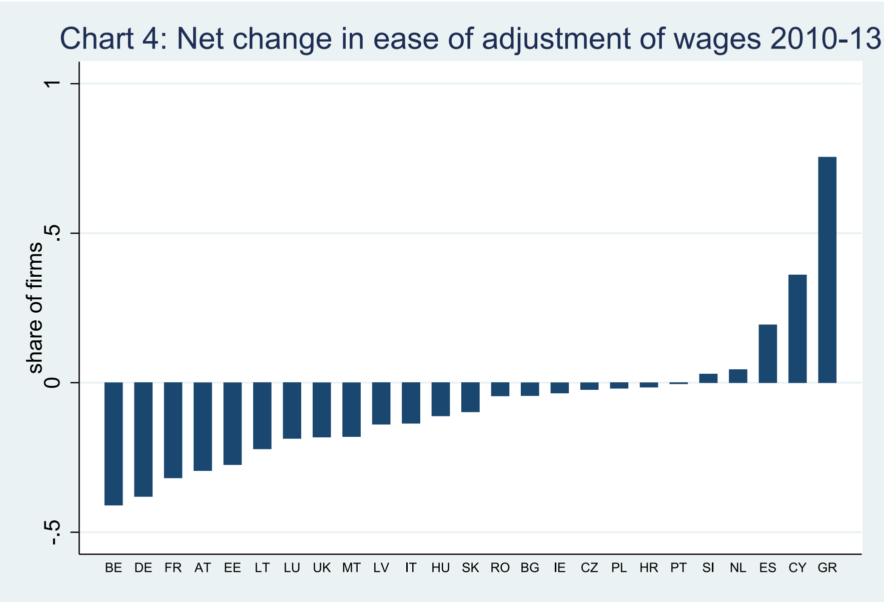
Source: Authors' calculations on the basis of the WDN3. Note: The figures are rescaled to exclude non-responses.

When asked why adjustment had become easier, the most frequent (i.e. modal) answer reported by firms in the reform countries was indeed the reform of labour laws. Firms' perceptions of the ease of adjustment, as recorded in the WDN3 survey, therefore contain important information on the effectiveness of these labour market reforms. However, it must be borne in mind that the ease of adjustment may also hinge on other factors. For example, those Spanish and Greek firms that reported that cutting incumbents' wages was easier in 2013 than in 2010 attributed particular importance to changes in workers' attitudes, as did firms in non-reform countries.[3]

Another finding of the survey is that even in countries that had significantly reformed their labour markets there were still firms that found it more difficult to adjust in 2013 as compared with 2010. Charts 3 and 4 account for this fact and provide a cross-country overview of the net change in the ease of adjustment. The graphs display the difference between the share of firms reporting that it had become easier and the share reporting that it had become more difficult to adjust employment (average across channels) and wages (average across incumbents and new hires). Negative values therefore indicate that more firms found it harder rather than easier to adjust. Consequently, the positive values for the countries where the largest and most wide-ranging labour market reforms were implemented further demonstrate that reforms have facilitated labour market adjustment.



Source: Authors' calculations on the basis of the WDN3. Note: The figures are rescaled to exclude non-responses.



Source: Authors' calculations on the basis of the WDN3. Note: The figures are rescaled to exclude non-responses.

Multivariate analysis of firms' characteristics and the environment in which they operate sheds some light on the features of those firms that were more prone to benefit from the greater ease of adjustment of labour costs. Larger firms and those applying agreements negotiated at firm level were more likely to find it easier to lay off and to hire employees; in addition, the group of firms with firm-level wage agreements also found it easier to adjust wages. In contrast, firms employing a higher share of skilled employees were less likely than those with relatively more unskilled workers to find it easier to adjust wages and lay off employees.

To conclude, the WDN3 evidence shows that recent reforms were effective in facilitating labour market adjustment during the crisis period 2010-13. However, when looking at the ongoing recovery, the survey suggests scope for other structural reforms and measures that could facilitate job creation and promote high-quality employment. Indeed, in addition to the high levels of economic uncertainty characterising this recovery, a large share of firms in many EU Member States report that high pay-roll taxes and skill shortages are preventing them from hiring workers on open-ended contracts. Both these obstacles hint at measures and reforms to foster the recovery, namely fiscal measures and structural policies – such as policies on education. It is also remarkable that in many of the non-reform countries firing costs and high wages were reported as obstacles to job creation by a large share of firms.

References

Izquierdo, M. J.F. Jimeno, T. Kosma, A. Lamo, S. Millard, T. Rõõm and E. Viviano et al (2017), "**Labour market adjustment in Europe during the crisis: Microeconomic evidence from the Wage Dynamics Network survey**", Occasional Paper Series, No 192, ECB, Frankfurt am Main, June.

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[1] This article was written by Ana Lamo (Senior Economist, Directorate General Research, Monetary Policy Research Division). The author wishes to thank Michael Ehrmann, Geoff Kenny, Silvia Margiocco, Simon Savsek and Isabel Vansteenkiste, for their comments. The views expressed here are those of the author and do not necessarily represent the views of the European Central Bank and the Eurosystem.

[2] These countries, together with Italy, are the so-called stressed countries that implemented wide-ranging reforms. In Italy, however, most of these reforms only had an impact after 2013. In Portugal, the reforms mostly focused on facilitating employment adjustment, which explains the small percentage of Portuguese firms that found it easier to adjust wages.

[3] Firms were asked which of the following four factors made it easier or more difficult to perform the above actions: a) reforms of labour laws, b) a change in law enforcement, c) a change in the behaviour of trade unions, and d) a change in the behaviour of individuals. This question was not asked in every country in the sample; answers are available only for ten countries (the Czech Republic, Estonia, Spain, Greece, Croatia, Hungary, Italy, Luxembourg, Poland and Romania).

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