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RECENT LABOUR MARKET
DEVELOPMENTS IN EUROPE

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Abstract: This study analyses the labour market developments of selected 22 European countries during the last ten years. The developments in employment and unemployment as well as the most essential distributive effects are presented. The labour market policy reforms of Denmark, the Netherlands, Finland, the United Kingdom and Germany are studied more into detail by assessing the similarities and differences and gathering together the main experiences. Interconnections between incentives and the functioning of the labour market are analysed through the strictness of the employment protection legislation, replacement rates of unemployment insurance benefits and early retirement schemes. There is wide dispersion in employment and unemployment across countries. Female participation in the labour market is rising. Employment rates for the aged workforce have increased during the last few years, but the situation of the young people has not been improved. Common factors for successful labour market policy reforms seem to be benefit reforms, changes in the organisation of the public employment service and activation policies. Employment protection legislation should not be discussed in isolation, but rather in interconnection with the functioning of the labour market.

Key words: European labour market, employment, labour market policy reforms, incentives

Tiivistelmä: Tutkimuksessa tarkastellaan valikoitujen 22:n Euroopan maan työmarkkinakehitystä viimeisen kymmenen vuoden aikana. Työllisyyden ja työttömyyden kehitystä ja keskeisiä jakaumavaikutuksia eritellään. Tarkemmin tutkitaan Tanskan, Alankomaiden, Suomen, Britannian ja Saksan työvoimapolitiittisia uudistuksia ja arvioidaan niiden eroja ja yhtäläisyyksiä sekä kootaan yhteen kokemuksia. Insenttiivien ja työmarkkinoiden toiminnan välisiä yhteyksiä tarkastellaan työsuhdeturvainsäädännön tiukkuuden, työttömyysturvan korvausasteiden ja varhaiseläkkeiden kautta. Työllisyydessä ja työttömyydessä on suurta hajontaa eri maiden välillä. Naisten osallistuminen työmarkkinoille on kasvamassa. Ikääntyneiden työllisyys on noussut viime vuosina, mutta nuorten tilanne ei ole parantunut. Menestyksellisille työvoimapolitiittikan uudistuksille yhteistä näyttävät olevan etuus uudistukset, julkisen työvoimapolitiittikan organisaation muutokset sekä aktivointipolitiittikka. Työsuhdeturvainsäädäntöä ei pitäisi tarkastella erillisenä kysymyksenä, vaan yhteydessä työmarkkinoiden toimintaan.

Asiasanat: Euroopan työmarkkinat, työllisyys, työvoimapolitiittiset uudistukset, insenttiivit

Foreword

This research report analyses the recent developments in the European labour market from a broad perspective. Issues like what have been the trends in employment and unemployment during the last ten years are discussed as well as full-time equivalent employment rates. Also, distributive themes like the differences between the sexes, age groups and people with different educational attainment in terms of employment are presented.

Five interesting labour market policy reforms are focused into more detailed discussion. These include Denmark, the Netherlands, Finland, the United Kingdom and Germany. Besides the national characteristics, some common themes behind these successful labour market reforms can be identified. These include e.g. benefit reforms, reorganisation of the public employment service and activation issues.

Structural incentive issues are analysed by studying employment protection legislation, replacement rates for unemployment benefit schemes and early retirement systems. An interesting discussion concerning the interconnections between incentives and the functioning of the labour market follows.

This study which has originally been prepared for the Council of Europe gives a broad macro level picture of the European labour market developments based on 22 countries. The outcome is a wide European diversity and some relevant interconnections between the incentives and labour market performance. Some lessons are also learned from the reforms. Labour market issues should not be discussed in isolation, but rather in interconnection with each other to give a more coherent picture of the mosaic of the labour market, which this report tries to do. The author, Dr. Heikki Räisänen is research director at the Government Institute for Economic Research (VATT).

Helsinki, October 2005

Reino Hjerppe

Director General

Summary

This report consists of three empirical parts: a description of labour market developments and some distributive aspects in 22 European countries, a more focused labour market reform analysis in five relevant countries and a description of incentive structure and its interconnections to the labour market.

Labour market developments in selected 22 European countries differ in many respects from each other since 1994. In terms of employment rate and unemployment rate changes the development in Ireland, Spain, Finland and the Netherlands has been most positive, as the opposite is true for Poland and the Czech Republic. The full-time equivalent employment rate indicates, how much work the working-age population really does and this indicator ranks Denmark, Sweden, Portugal and Finland highest.

Average female employment rates across countries have risen and unemployment rates gone down between 1999 and 2003, but the development for males has been worse with some losses in employment rates and the unemployment rates staying more or less the same. The mean employment rates in the age group 15-24 dropped, rose slightly for the age group 25 to 54 years and rose on average for over four percentage points for the 55-64 –year-old population. The employment rates for people with lower than secondary education have risen most, but the observed changes are modest. By calculating the variances in employment rates for different age groups, educational attainments and both sexes for the year 2003, the outcome can be interpreted in such a way that the highest variance would also mean the greatest room for improvement. The greatest employment potentials in this respect can be found for the youth, the elderly and people with less than upper secondary education and females.

The labour market policy reforms carried out in Denmark, the Netherlands, Finland, the United Kingdom and Germany are discussed more into detail. Many European countries have done important labour market reforms, but in many respects these five reforms represent many of the ideas which have been present on the policy agenda in other countries as well. The unemployment rate and the share of long-term unemployment have clearly decreased in these countries during the reforms with the exception of Germany which started the reforms at a later stage. All reforms have created some special innovative characteristics of their own, but they all have also common features. The most important common areas of reform seem to be unemployment benefit reforms, the role of the public employment service and activation policies.

Employment protection legislation concerning the protection of regular workers against individual dismissal and the regulation of temporary employment has generally been eased from the late 1980s to the late 1990s in European countries. In the last few years after a period of deregulation the development has been more moderate as the strictness of this kind of regulation has remained the same in most countries.

Unemployment benefit net replacement rates vary widely across European countries at average production worker wage levels. The tax-benefit systems for 22 countries suggest that unemployment-based net replacement rates for single persons become much stricter in the course of unemployment in relation to a couple with children. This family-friendliness also means that there are hardly better economic incentives for job-finding for a family with children even with longer unemployment duration. For single persons, the incentives become clearly better in time.

Interconnection between the strictness of employment protection legislation and the share of fixed-term employment can be found: the increase in the EPL strictness is connected to some kind of increase in the share of fixed-term employment. It is important that all relevant policy changes are discussed in interconnection with each other and not in isolation, as in the modern labour market several behavioural effects can follow from separate changes.

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1. Introduction and Motivation for the Study

I address in this study labour market developments in selected European countries in the last ten years. The developments during the last few years are focused. This period after the recession years in the beginning of the 1990s has faced relatively stable economic growth in many European countries. However, the European countries represent a diversity of economic structures and performance which also have an effect on labour market developments.

Recent trends in employment and unemployment form an important general background for understanding the labour market development in the European countries. Also some distributional effects will be discussed, e.g. how are employment and unemployment distributed among the population. Is the modern labour market based on a selection between full-time employment and non-employment or a more flexible selection between various forms of these two? Where are the most promising prospects for job-creation?

Some of the most interesting labour market policy reforms are discussed into more detail. Especially the Danish and Dutch labour market reforms have been thoroughly investigated by other European countries and often referred to in policy discussions. Auer¹, e.g. considers small countries like Austria, Denmark, Ireland and the Netherlands as success stories in terms of labour market performance, but also other countries' labour market developments will be discussed. Is there something in common between the most interesting labour market reforms, like a broad combination of economic policy measures, tax-benefit reforms, wage moderation and more targeted labour market policy issues? This part is based on the experiences from five countries' reforms: Denmark, the Netherlands, Finland, the United Kingdom and Germany.

The main features of employment protection legislation and unemployment benefit systems are also discussed. One approach to how the labour market function is the routes of early exit from the labour market and the varying incentive structures. This discussion is closely connected with protecting the employees against the risks of unemployment, social exclusion and sickness². Are there some unintended side-effects besides the re-employment effects and the social security aspect caused by these arrangements? This part is based on the developments in about 20 European countries and more specifically on the experience in Denmark, Finland, the United Kingdom, Italy, the Netherlands, Spain and Sweden.

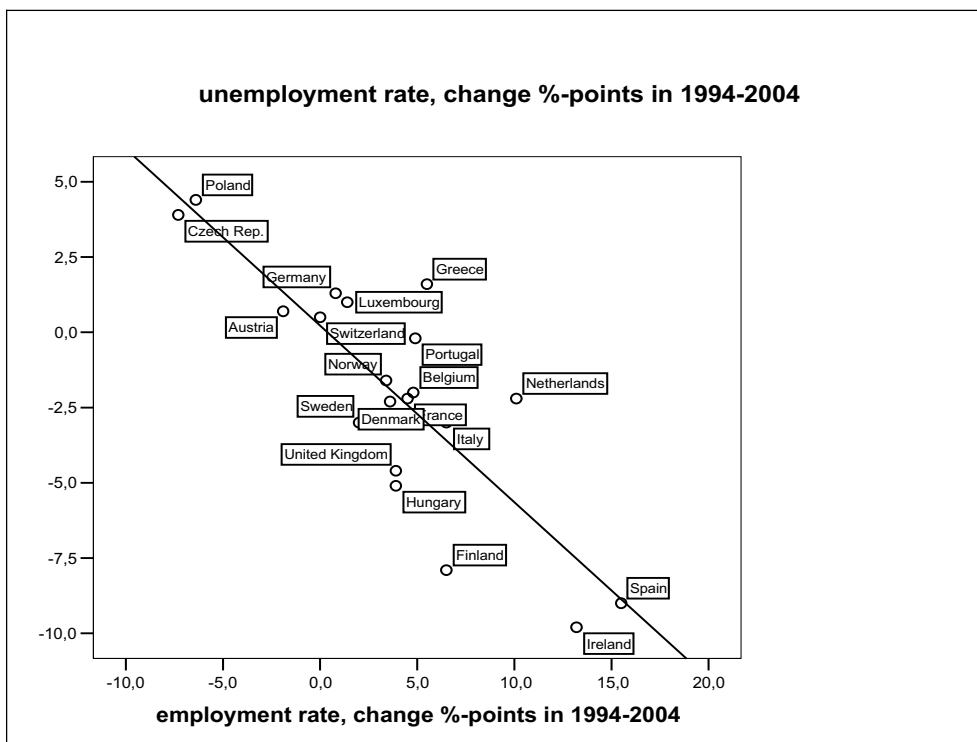
¹ Auer (2000 and 2001).

² Remain in or withdraw from the labour market (2003).

2. Recent Labour Market Developments in Selected European Countries

2.1 Employment and Unemployment

Figure 1. The dependence between changes in employment rate and unemployment rate in 1994-2004

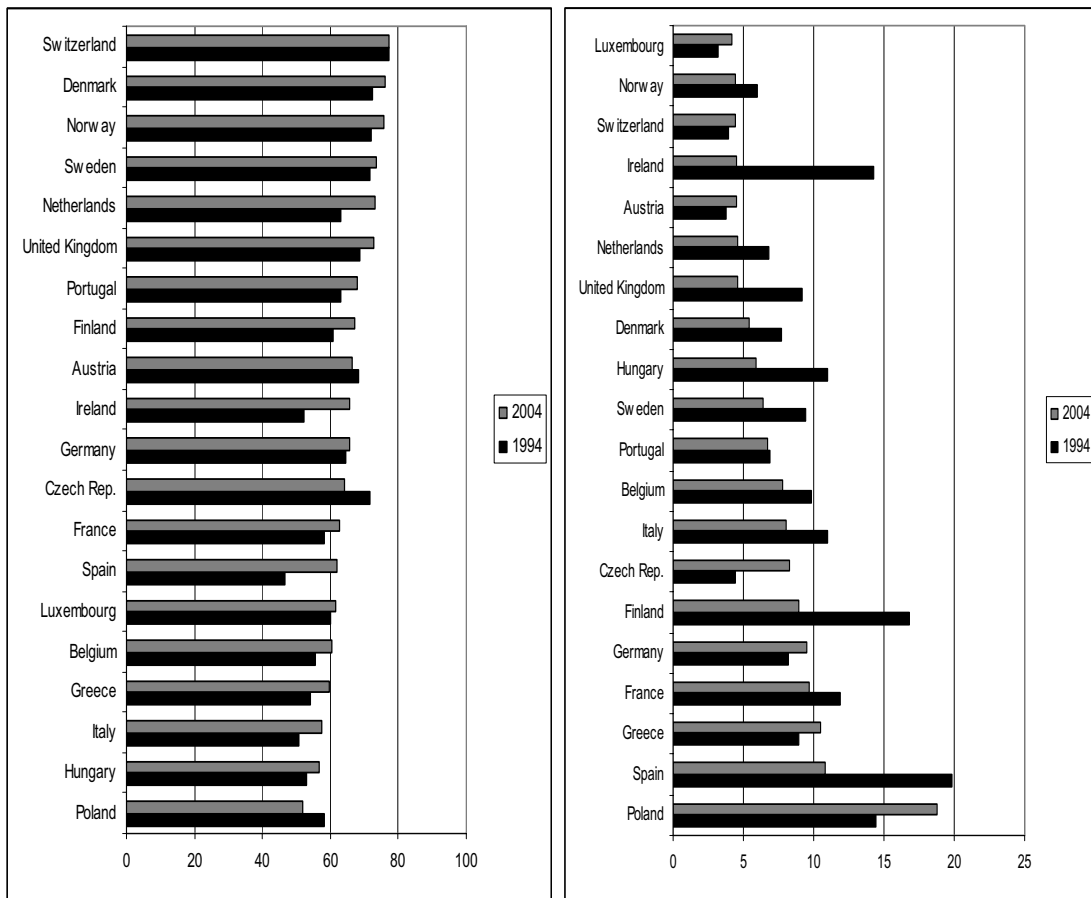


Source: OECD 1996, 1999, 2005³.

On the one hand, the development in the last ten years has been most positive in Ireland, Spain, Finland and the Netherlands. On the other hand, the developments faced in Poland and the Czech Republic are clearly on the negative side in terms of employment rate and unemployment rate changes. The dependence of these two labour market indicators on each other differs from others in some countries. Of the successful countries, Spain and Finland have quite similar cuts in unemployment rates, but the Spanish increase in employment rate is really remarkably better. The Netherlands has experienced heavy employment growth, but this increased labour demand has been filled mainly with other people than the unemployed, as these labour resources have been very limited in the Netherlands.

³ The regression model is: $Y=0.22-0.59X$, $r^2=69\%$, $\text{sig.}=\text{***}$.

Figure 2 a and b Employment rates (a, left) and unemployment rates (b, right) in 1994 and 2004, selected countries⁴



Source: OECD 1996, 1999, 2005⁵.

In figure 2 employment rates and unemployment rates in 1994 and 2004 are presented. The best performers in 2004 are on the top of the figures.

In the longer period of time, labour demand and supply are heavily dependent on each other. In 1991-2001, a cross-country trend line for 21 countries suggests that a 1-percentage point change in employment is connected with a respective change in labour supply (labour force participation rate) by about 0.7 percentage points.

Studying further the models of participation in the labour market for both sexes separately shows that for males, the cross-country dependency⁶ between changes

⁴ Employment rate, % = (employed people₁₅₋₆₄ / population₁₅₋₆₄) x 100

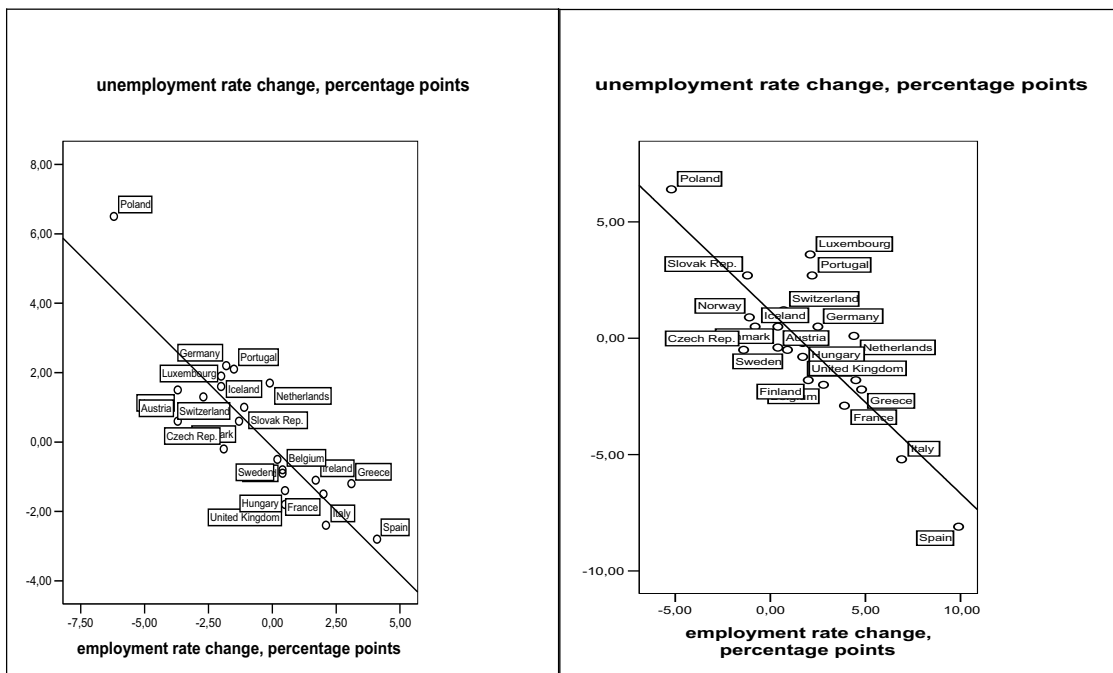
unemployment rate, % = (unemployed people₁₅₋₆₄ / labour force₁₅₋₆₄) x 100.

⁵ Employment rates for Iceland, Norway, Spain, Sweden and the UK refer to the age group of 16-64 years. These apply for figures 1, 2 and 3.

in employment rates and unemployment rates forms a narrower deviation around the trend line than for females. The unemployment rate change in 1999-2004 is not as good as expected based on average employment rate change in Poland, the Netherlands, Portugal and Germany for both sexes and is better than expected in the Czech Republic for both sexes. Besides these, for females in Luxembourg the unemployment rate development has not been as good as expected and on the other hand, for females in Spain, France, Belgium, Finland and Denmark the result is better than expected. For males, the developments in the United Kingdom, Hungary, Austria and Norway are better than expected based on the trend line. However, despite the still high level of unemployment, Spain is the best performer for both sexes in terms of employment rate change as well as unemployment rate change during the last few years. These kinds of cross-country dependencies should be interpreted with caution, but the models slightly indicate that female unemployment (and probably also labour supply) is more dependent on other factors than labour demand in comparison with the more straightforward dependence for males. In those countries which are highest over the trend line, either labour supply has probably increased more than in other countries in relation to the employment rate developments or the matching of labour demand and unemployment is not very good and under the trend line, the situation is just the opposite.

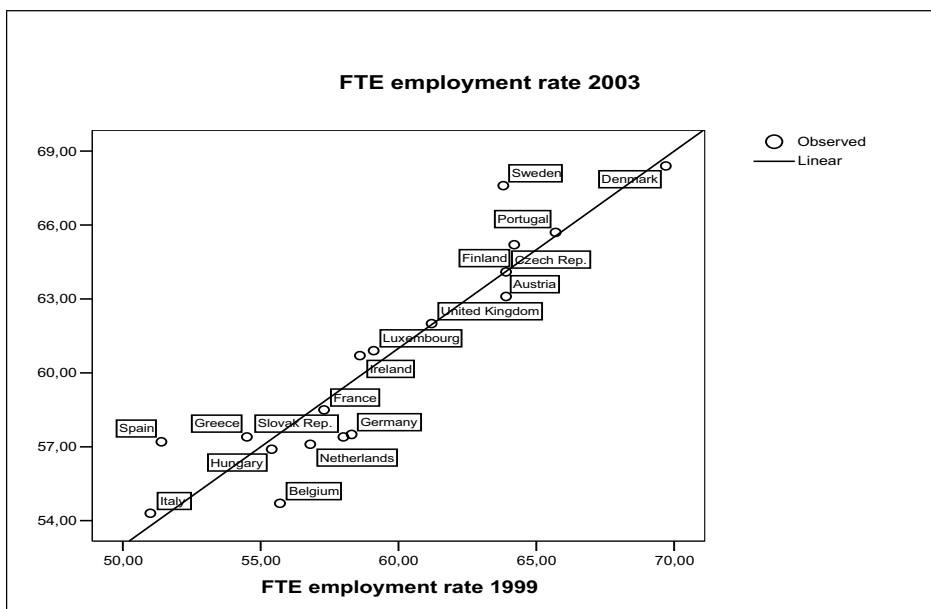
⁶ the linear regression model for males in 1999-2004 is: $Y(\text{unemployment rate change \% - points}) = -0.14 - 0.73X$, $r^2 = 75\%$, sig. = ***, where $X = \text{employment rate change \% - points}$. The respective model for females is: $Y = 1.17 - 0.78X$, $r^2 = 69\%$, sig. = ***.

Figure 3 a and b. The dependence between employment rate change and unemployment rate change for males (a, left) and females (b, right) in 1999-2004



Source: OECD (2004, 2005).

Figure 4. Full-time equivalent employment rates⁷ in 1999 and 2003



Source: Employment in Europe 2004⁸.

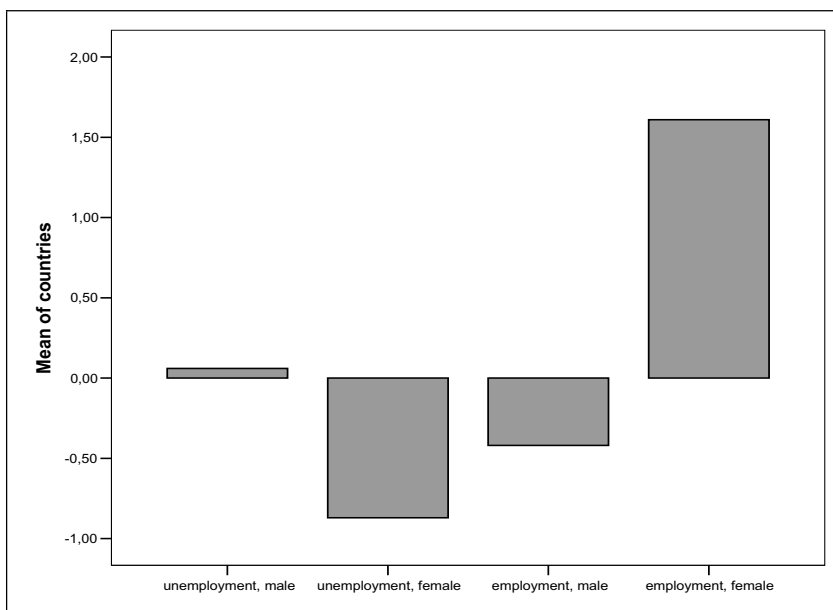
⁷ The FTE employment rate is defined as total hours worked on both, main and second job divided by the average annual hours worked in full-time jobs within the country, see Employment in Europe (2004, 268).

As the standard employment rates just show the incidence of employment among the working age population, the full-time equivalent (FTE) employment rates indicate, how much work this population really does. Denmark, Sweden, Portugal and Finland reach high FTE employment rates in both years, as Italy, Spain, Hungary and Belgium are at the other end. Considering the development between 1999 and 2003, Sweden and Spain have performed best in this respect, but also Greece, Finland, Ireland and Luxembourg have improved their full-time rates from 1999 to 2003. Belgium, the Netherlands and Germany are lowest under the cross-country trend line. For the Netherlands, part-time employment is especially important.

2.2 Distributive Aspects

Taking the cross-country means into consideration, not much has happened for male unemployment or employment in 1999-2003. Slight losses in employment are the mean outcome. The situation for females is, however, positive. On average, unemployment has fallen and especially the female employment rate has improved remarkably in a relative short period of time.

Figure 5. *Change in unemployment and employment rates for men and women, cross-country means for 1999-2003 percentage points, 20 countries⁹*



Source: OECD (2002, 2004).

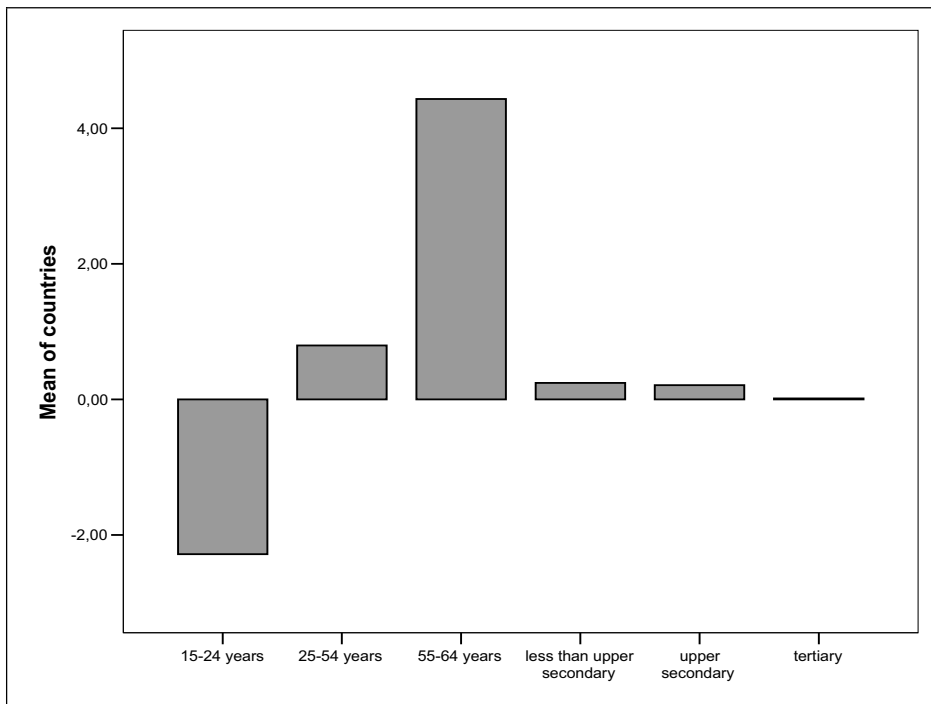
⁸ The full-time equivalent employment rates representing the situation in 2003 are for the year 2002 for Ireland and Luxembourg.

⁹ Includes Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, United Kingdom and Slovak Republic.

Participation in working life among various age groups has changed during the last five years. As young people were less employed in 2003 compared with 1999, the prime age cohorts between 25 and 54 years of age have improved their participation in work somewhat, but the main gains in terms of employment rate increase has occurred among those people between the ages of 55 and 64.

The mean employment rate for 19 countries (unweighted cross-country mean) in the age group 15-24 dropped from the 1999 figure 43.2 per cent to 41.5 per cent in 2003, as the development in the 25 to 54 age group was from 78.1 per cent to 78.3 per cent, respectively. The mean employment rate for 55 to 64 year-old people rose from 41.4 per cent to reach 44.7 per cent in 2003.

Figure 6. Changes in employment rates for various age groups between 1999 and 2003 and for educational levels between 1999 and 2002 for the 25-64-year-old population, cross-country means¹⁰



Source: OECD (2001, 2004).

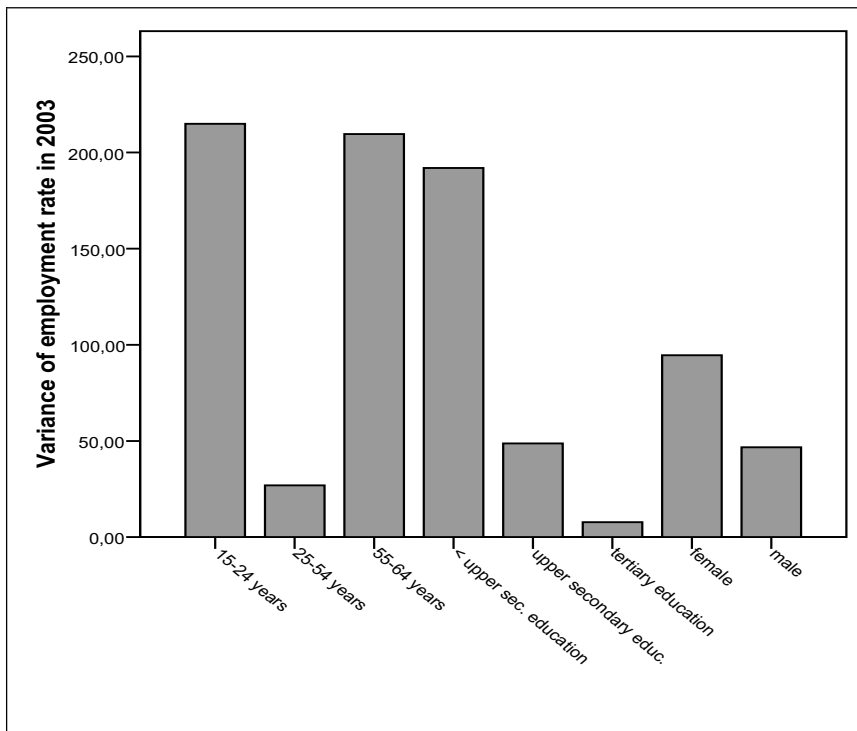
Between various educational attainment levels for the age groups 25-64, the differences are much more modest as also the time period is one year shorter. However, during the last few years, the employment rates have on average risen

¹⁰ The countries for age groups are: Austria, Belgium, Czech Republic, Denmark, Finland, Germany, Greece, Hungary, Ireland, Italy, Netherlands, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland and United Kingdom. For educational attainment also France, Iceland and Luxembourg are included in the calculation, but information for Slovak Republic is missing.

slightly for those people with upper secondary education or less as the rate for people with tertiary education has remained at the same level.

It is also clear that people are more employed as educational attainment improves: the employment rates by educational level differ heavily. People with less than upper secondary education had especially low employment rates in the Slovak Republic, Hungary and Poland, as the rates for people with tertiary education were low in Greece and Spain compared with others. Iceland was on the top in both respects, but also Switzerland, Portugal and Norway had high employment rates for both groups in 2002. Comparing employment with educational attainment across countries, it is reasonable to take the age group starting from 25 year-old population, as tertiary degrees are achieved at even higher ages in some countries.

Figure 7. Variance in employment rates for various groups in 2003, 15-64 year-old population



Sources: OECD (2004), Employment in Europe (2004).

Comparing the variances in employment rates for different age groups, educational attainments and both sexes for the year 2003, it is possible to interpret the outcome in such a way that the highest variances across countries would also mean the greatest room for improvement. The variances for the youth, the elderly and people with less than upper secondary education and females are higher than for their counterparts. This outcome would also be a starting point for formulating employment policies if equality between different groups of the population is

an important policy aim. High employment for the highly educated prime-age people is a competitive factor, but there exist no major possibilities for remarkable improvement in this respect.

Clustering¹¹ the selected countries, on the one hand, based on a very general labour market change in 1994-2003 (employment rate and unemployment rate changes) and, on the other, based on the state of the labour market, some interesting cluster combinations are found. The labour market developments combine Ireland, Spain, Finland and the Netherlands in the same cluster as the Czech Republic and Poland are together one cluster. The former group of countries has experienced positive labour market developments as the latter have faced shocks in the labour market. All other 14 countries form one cluster which is between these two as to labour market development.

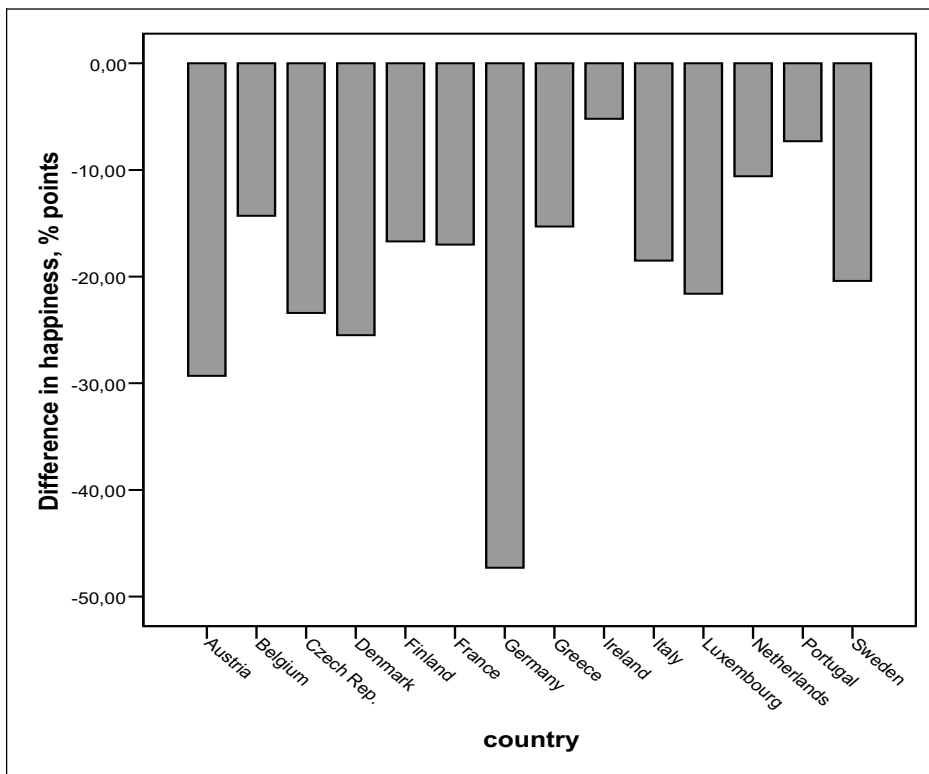
Clustering the state of the labour market for 2002 and 2003 to reach the most recent picture, interesting geographical clusters are found: the Southern European countries Greece, Spain and Italy form one cluster, the Nordic countries Finland, Sweden, Norway and Denmark form another as the rest 13 (Central European) countries build the third cluster. The Nordic countries have high female employment rates, as the Southern European countries (with the exception of Portugal, which belongs to the broad “Central European” cluster) have low female employment rates. This kind of very preliminary grouping of countries indicates, however, some key elements of the labour market.

An important subjective aspect is how happy people in different labour market states are with their lives. Taking 14 countries into consideration, people in full-time employment (more than 30 hours of work weekly) are generally happier than the unemployed in all countries in 1999-2001 not taking any other variables into account. This indicates that work in itself is an important aspect of well-being and happiness. The unhappiness of the unemployed in relation to the full-time employed is greatest in Germany, Austria, Denmark and the Czech Republic. Ireland, Portugal and the Netherlands represent the other end in this respect. This outcome is based on the difference between the full-time employed and the unemployed who felt themselves at least “quite happy” with their lives in 1999-2001. The differences have become wider in 1999-2001 in relation to 1995-97.¹²

¹¹ The dendograms of the cluster solutions are presented in the appendix.

¹² World Values Survey (1995-97), (1999-2001).

Figure 8. *The difference in happiness between the unemployed and the full-time employed in 14 countries in 1999-2001, percentage points*¹³



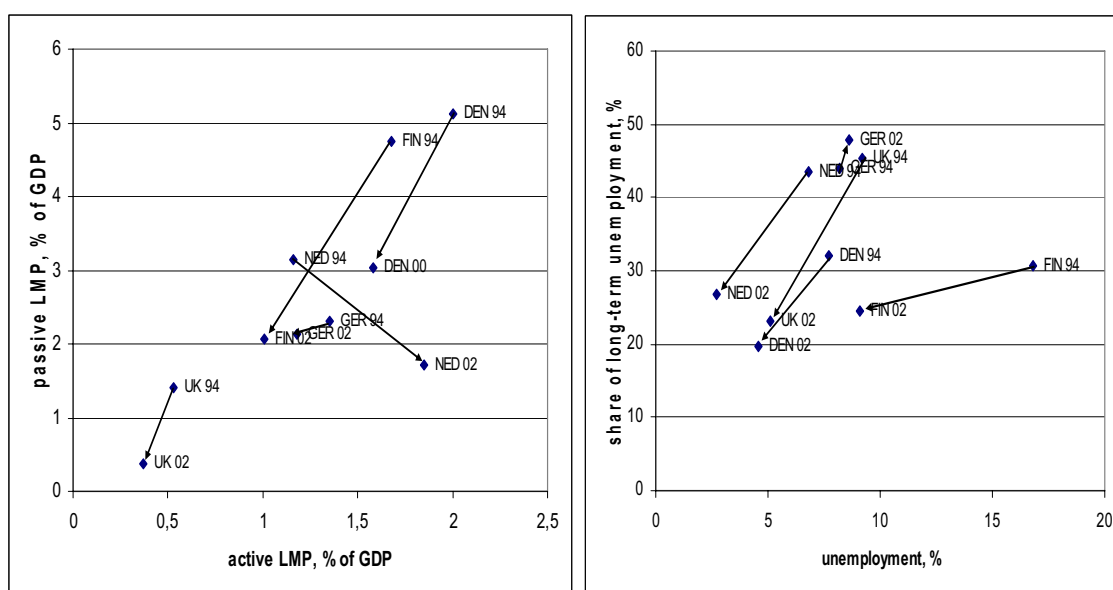
¹³ Correlations for the happiness of the full-time employed and the unemployed between various other variables show that in various subgroups employment rates and the happiness of the full-time employed have high positive and significant correlations, but this is not observed for the unemployed. Also male and especially female unemployment and the happiness of the employed have high negative and significant correlations, but they are not observed for the unemployed. The EPL index and the happiness of the employed have also high and positive correlation, but the observed correlation between that variable and the happiness of the unemployed is negative, but not significant. Various unemployment benefit net replacement rates and the happiness of the employed have positive and significant correlations, but this is not the case for the unemployed. The only observed significant correlation between the happiness of the unemployed and other variables (except the happiness of the employed) concerns unemployment assistance duration.

3. Experiences from Labour Market Policy Reforms

Labour market policy reforms can be considered either once-and-for-all measures or like a continuum. Especially in the latter case, the basic ideas and policy lines behind the reforms are important since they are implemented in many phases. It is also more difficult for the implementers of certain policy to adopt the basic ideas if the reform is a once-and-for-all type of reform in comparison with having a chance of adopting them during a longer period of time.

In the following, labour market policy reforms from Denmark, the Netherlands, Finland, the United Kingdom and Germany are discussed into more detail. Many European countries have carried through important labour market policy reforms, but in many respects these reforms represent many of the ideas which have been on the policy agenda in other countries as well.

Figure 9 a and b. Expenditure on active and passive labour market policy (a, left) and unemployment and long-term unemployment (b, right) in 1994 and 2002, selected countries¹⁴



Source: OECD 1996, 2002, 2004.

These countries have experienced heavy changes both in terms of labour market developments and policies to improve the functioning of the labour market. The development in active and passive labour market policy resources in relation to GDP indicates that in these countries, the public expenditure is probably more dependent on the external shocks in the labour market and the expenditure reacts

¹⁴ In figure 9 a, the figures of Denmark refer to the year 2000.

to this rather than shows a clear trade-off between active and passive policies. Only the Netherlands has increased active spending on labour market policies between 1994 and 2002 with simultaneous unemployment cuts. The level of unemployment has decreased and its structure has improved in all other countries except Germany where the situation has worsened somewhat between 1994 and 2002.

Labour market policies consist of two main elements, the active and passive component. The active part can be further divided into public employment services and administration, labour market training, youth measures, subsidised employment and measures for the disabled where the passive part consists of unemployment compensation and early retirement for labour market reasons¹⁵.

3.1 Danish Continuum of Reforming

Denmark used to have a very long-lasting (9 years) and passive compensation system for the unemployed before the LMP reform period beginning in 1994. Active labour market programmes were offered to persons immediately prior to the expiry of the benefit period and participation in these programmes generated an entitlement to a new benefit period. This indicates that also the role of the active programmes was highly passive. Denmark reformed its labour market policy in several phases in 1994, 1995, 1996 and 1999. The reforms have continued also in the last years. The basic guiding principles in the Danish reforms were needs-orientation, decentralisation and involvement of the social partners¹⁶. The Danish reform is in practice based on activation of the job-seekers, defining the rights and duties of the unemployed job-seekers and reducing the benefit periods. The number of persons participating in active labour market policy measures in relation to the unemployed and persons in active measures has increased.

The unemployment insurance system in Denmark is a voluntary one. The replacement rate especially for low-wage earners is high, 90 per cent of previous wages, which tends to create incentive problems. Also other forms of passive LMP are relatively extensive, like various leave schemes and post employment wage. Also the costs of active measures and the total LMP costs have been criticised to be the most expensive in the world¹⁷. The unemployment insurance system is also a very long-lasting welfare system in comparison with other countries even if it has been reduced, but with extended activation periods, the joint duration period is still four years.

¹⁵ Sihto (2004) verifies with the Finnish case that it is not always clear what the outcome of active and passive LMP is as e.g. in the late 1960s and early 1970s the cuts in active measures in the Finnish LMP meant an end for the conservation of the production and skills structure especially in the depressed regions, which actually improved fulfilling the targets of active LMP by more passive policy measures.

¹⁶ Maerkedahl (2000).

¹⁷ Westergaard-Nielsen (2001).

The combination of security and flexibility has been clearly present in the Danish reforms. As a large repertoire of passive measures with a high replacement rate has represented security for the people facing unemployment, the active measures and ceased entitlement to unemployment insurance benefits through participation in active measures have created more flexibility. Earlier intervention with active measures has helped many job-seekers and the quality of the active programmes has been improved. In some sense the leave schemes also support labour market flexibility, as labour turnover is high and this is not only supported by lay-off systems, but labour market training and leave schemes¹⁸, which improve qualifications and give possibilities for the unemployed to get a job. The results for cutting youth unemployment have been good, which has been achieved by a combination of rights and obligations: the young especially have to participate in activation programmes or they lose benefits.

During the implementation of the LMP reforms from mid-90s to the end of 1990s, Denmark has been able to cut open unemployment heavily and increase the traditionally high employment rate further as the growth rate of the economy also was relatively good. The gender gap in employment and unemployment is low in comparison with many other European countries. Between 1999 and 2003, however, the employment rates for both men and women have dropped somewhat and male unemployment has increased a little.

The development during the last few years seems to call for further policy measures. The Danish government presented a labour policy strategy “More people at work” in 2002 in order to increase the labour force participation rate especially by supply side measures. Also a structural reform of the Public Employment Service will integrate the services of the PES and the municipalities with each other for both the insured and uninsured unemployed job-seekers, who have been served separately. Outsourcing is also on the agenda as regional administrative reforms and so are profiling systems for the job-seekers.

The Danish model can be described to have a highly flexible employment relation, a high level of social protection on individual level combined with active labour market policy. The system defends the individual from the potential costs caused by low level of employment security. The job mobility is high in Denmark and respectively, job tenure is low.¹⁹

The combination of reducing passive benefits, increased and earlier activation together with labour market dynamics and creating a more transparent system by introducing the rights and obligations have proved to be successful for Denmark in the 1990s. The development in the last few years is more unclear. The cost burden of this policy is also heavy. It is possible that employment prospects are

¹⁸ Auer (2000).

¹⁹ Madsen (2002, 52,61).

mainly dependent on economic growth²⁰, but the Danish way of continuous broad LMP reforms has clearly offered much for the rest of the European countries, as well.

3.2 The Dutch Model

The Netherlands has a different profile from other countries at least with respect to part-time work: in no other (EU) country is part-time employment as widespread as it is in the Netherlands. It is a predominant feature of female employment²¹. Whether women's participation will continue like this or turn towards full-time jobs is one of the main challenges for the Netherlands²².

The three most important policy changes in the Netherlands affecting the labour market have been wage moderation, social security reforms and active labour market policy reforms. Unemployment and disability benefits were made less generous and e.g. the eligibility conditions for unemployment benefits were tightened in 1991 and 1995. The active labour market policy measures were especially targeted to young people and the long-term unemployed and the main measures in the Netherlands are education and training, employment subsidies and training measures. The Public Employment Service was reformed and cooperation with private sector temporary work agencies was one part on the reforms in the early 1990s. Child care schemes and increased employment flexibility have increased female labour supply.²³

A policy of flexicurity which tries to combine temporary work flexibility with the security aspects of permanent jobs is one special Dutch feature²⁴. It is also argued that because of the flexibility the demand and supply of labour matches better than in some other countries. Also some preventive elements like higher costs for firms in case of disability have had an effect on the behaviour.²⁵

One of the most interesting phenomena in the Netherlands from other countries' perspective has been the employment service reforms in the 1990s. In 1996 part of the PES funding was redirected to the municipalities and social insurance agencies in order to purchase reintegration programmes for the hard-to-place job-seekers. The private placement agencies and temporary work agencies have a high relevance in the way of functioning of the Dutch labour market. So a part of the PES is privatised and it competes with other placement channels²⁶. However,

²⁰ Westergaard-Nielsen (2001).

²¹ Fouarge – Baaijens (2003).

²² Auer (2000).

²³ Barrell – Genre (1999).

²⁴ Wilthagen (1998) discusses into more detail these 1997 legislative changes.

²⁵ Auer (2000).

²⁶ de Koning (2000).

the focus of the PES is in difficulties on both sides of the labour market: on the supply-side the hard-to-place job-seekers and on the demand-side, the hard-to-fill vacancies²⁷.

The Dutch model is based on rather different elements from many other European countries. The characteristics of the labour market like a really large share of the voluntary part-time work, innovative ways of reorganising the delivery system and implementation of the labour market policy jointly with other actors and the way of tripartite co-operation have produced a low unemployment rate with simultaneous increases in ALMP spending during the last years as the cost burden on passive LMP has been eased.

Full-time equivalent employment rates are not very high for the Netherlands because of the large-scale part-time working model applied, but the success in terms of cutting unemployment is remarkable. One problem is still a high rate of subsidised inactivity, i.e. the high number of benefit recipients in relation to the employed. Corporate institutions seem also to allow much flexibility.²⁸

3.3 Two Finnish Reform Waves

In the beginning of the 1990s Finland faced the steepest economic shock ever experienced in the industrialized market economies after the Second World War. The outcome of this recession in the labour market was severe: unemployment rose from 3.2 per cent level in 1990 to 16.6 per cent in just four years, the employment rate decreased about 14 percentage points in five years as labour demand collapsed. Then, after a couple of years of rapid economic growth in 1996, it was found out that the labour market was still in the recession position, the labour market did not function in a satisfactory manner and even active labour market policies were implemented in a passive way, there existed addiction to subsidies and the effectiveness of the LMP measures did not meet the requirements set to them²⁹.

In the 1998 labour market policy reform the idea was, by improving the employment service process, by activating the flat-rate (unemployment benefit) passive labour market support scheme for job-creation, by reforming the active measures and by defining the rights and obligations of the unemployed job-seekers, to form a more coherent whole of the separate measures. A stock of five per cent of the labour force was participating in the active measures in 1997, which was considered inefficient and costly. The Danish reforms had an effect on

²⁷ van Yperen (2000).

²⁸ Hartog (2002).

²⁹ Räsänen (2000).

the Finnish system especially as to the definition of the rights and obligations of the unemployed job-seekers.

The volume of active labour market policy programmes, especially the employment subsidies and direct job-creation was reduced to about 3.5 per cent stock level of the labour force. Increased activation and effective job-search was aimed at by large-scale short-term job-search training. The participant inflow into these one or two-week training periods was at 120,000 level annually at its highest. Structural unemployment actually evolved in Finland much later than in many Central European countries. This difficult problem was dealt in LMP with creating subsidised jobs in the so called third sector of the economy for persons who had been unemployed at least 500 days (uninterruptedly about two years).

The Finnish way of reforming is, compared with the Danish one, more of a once-and-for-all type but, however, the reform was continued in 2002. This was based much on the evaluation outcome of the 1998 reform. According to the evaluations, the job club method was the most successful part of it helping job-seekers' own activity in open labour market job-search and improved the skills and activity of the participants³⁰. The reform was best implemented among the low-skilled middle-aged job-seekers who already had a long unemployment duration.

In the second wave of the labour market policy reform since 2002, the problems of the functioning of the labour market and the structural unemployment were the main motives to continue the reform. The employment services were developed more into the direction of separating them, on the one hand, for open labour market job-search purposes and, on the other, more in-dept upgrading of activation and skills for those who face a more difficult situation in the labour market. Employment services were developed further based much on e-services and self-service facilities at the PES and equipment. The services of the PES, the municipality social and health sector and the Social Insurance Institution (SII) services were provided in the same joint service centres³¹. Compared to the Dutch way of privatising part of the PES and funding these different operators, Finland integrated the relevant public authorities to work together.

During the implementation of the reforms in 1997-2003, the total unemployment decrease was 29.7 %, but long-term unemployment (-41.9 %), recurrent unemployment³² (-32.4 %) and unemployment after participation in ALMP measures (-30.6 %) have decreased more. If these are considered as components of structural unemployment, it has clearly diminished due to preventive policy. It is highly unlikely that labour demand would have been targeted more heavily to-

³⁰ Arnkil, Spangar and Nieminen (2000), Malmberg-Heimonen and Vuori (2000).

³¹ Räisänen (2004).

³² Recurrent unemployment here refers to 12 months of unemployment in 16 months (but not in 12 months as the classes are mutually exclusive).

wards structural unemployment than unemployment in general without the contribution of labour market policies. Also tax-benefit reforms have contributed to this positive development. As more job vacancies than before are notified through the PES and the recruiting employers usually get the demanded labour according to their expectations, also the functioning of the labour market has been contributed by the labour market policy interventions. After a very difficult economic and labour market situation, Finland tried to reach better functioning labour markets and more flexibility without destroying the security elements. Even if unemployment is still at a high level, the development since mid-1990s is among the best of European countries.

3.4 The LMP Reforms in the United Kingdom

The labour market performance of the United Kingdom has been successful in the last ten years. The male employment rates are high reaching almost 80 per cent levels and for females, at 66 per cent level. The unemployment rate has decreased from 9 per cent level in 1994 to reach about 5 per cent in the last years. Especially impressive is the simultaneous improvement in the structure of the unemployment: long-term unemployment counted for 45 per cent of total unemployment in 1994, but only 23 per cent in 2002. Taking the good overall development into account, this is really a remarkable achievement as usually the most hard-to-place unemployed are left in the pool of unemployed in this kind of development.

Working time patterns are also an interesting phenomenon in the UK, but unlike in many other countries, there is actually no typical working time, but plenty of variance in this respect.

The expenditure on ALMP has been diminished since 1993-94. The employment service contracts out many of the operations as is the case in a number of other countries. The unemployment duration development is interesting as most of the improvement is amongst the long-term unemployed. The contribution of the LMP regime in this positive development is likely to be caused by keeping the unemployed in continuous touch with the employment service which takes advantage of the continuous turnover of vacancies. The dynamics of unemployment is at a high level as e.g. in 1999, 60 per cent of the unemployed left unemployment in three months and about 90 per cent in one year.³³

One explanation for this development is that people with longer unemployment duration leave unemployment not because of jobs but because of other benefits associated with inactivity, like lone parent, long-term sickness and disability

³³ Wells (2000).

benefits. One innovation in the UK is that employment policy covers also the economically inactive ones, particularly people receiving benefits.

The LMP system gives special attention to young people and the long-term unemployed with the New Deal programmes. The young job-seekers are not allowed to stay on benefits, but they are activated if personal employment services and job-search help does not lead to results. Young people have actually four options after receiving the Jobseekers allowance for six months: entry into full-time education or training, voluntary sector job for six months, public sector job for six months or a subsidy for the employer for six months. Evaluation applying micro data states that the New Deal programme has a significant employment effect: young men are about 20 per cent more likely to find jobs each month because of the New Deal³⁴. A former evaluation also confirms the positive outcome, but is more cautious in the interpretation³⁵.

ALMP for the inactive has as a first challenge to try to get the target group into the labour market before they can take up jobs. Integration of the benefit administration and the employment service has also been carried through in the UK. Basically, the benefits can be paid indefinitely if the conditions receiving them are met. The “work first” regime supported by effective administrative means to keep the job-seekers in recurrent touch with the labour market and active job-search behaviour indicates to produce beneficial outcomes³⁶. Administratively the British LMP system is decentralized and industrial relations are not based on corporatism, but rather pluralism³⁷.

In a way, the LMP system in the UK seems to emphasise the role of the employment service much more than in other countries, which rely more on a mix of PES and the active programmes. The idea of continuous job-search and taking advantage of the high dynamics and turnover of the job vacancies by enhancing active job-search behaviour is a very similar to the idea that has been implemented later in Finland.

3.5 Germany Starts Reforming

The German labour market development in the last ten years can be characterised mainly by the reunification process of the country, which has had deep effects. In general, unemployment has increased a little and its structure has also worsened as almost a half of the German unemployed have faced long-term unemployment. The resources devoted to labour market policy, both active and passive in rela-

³⁴ Van Reenen (2003), 13-21.

³⁵ Blundell – Meghir (2001), 256-263.

³⁶ Wells (2000).

³⁷ Schmid – Roth (2000).

tion to the GDP were on a somewhat lower level in 2002 than in 1994. The gender gap in employment rate is relatively large, but has become narrower between 1999 and 2003 by 3.7 percentage points. However, this development includes downward development in male employment rates.

The German labour market policy reform started with a thorough committee work which was published in August 2002, usually referred to as the Hartz commission.³⁸ Proposals for reform, 13 “innovation modules” can be grouped into three main areas: enhancing market and service principles at the public services, developing targeted services for the difficult-to-employ job-seekers and the development of the organisation and functions of the employment service³⁹.

The proposals also included unemployment benefit reforms with tighter rules for paying the benefits. The themes of flexibility and security are present also in the leading theme of the Hartz -commission⁴⁰, which emphasises that the alternatives offered match with the individual’s later employment perspectives and the advice and material security form an integrated whole.

The German PES is still considered as a central player in improving the functioning of the labour market, but also private actors will probably have a larger role in the coming years. One of the ideas in the German reform is to put job-broking, labour market information and other employment services in a central role and emphasise preventive measures more than before the reform. The main target groups for active programmes are the youth, the long-term unemployed and the elderly. The way in cutting unemployment is mainly based on trying to reach shorter unemployment spells, not so much on concentrating on the incidence of unemployment.

In the beginning of 2005, the unemployment benefit system was reformed and from 2006 on, the maximum benefit period will be limited to 12 months with a slight exception for the aged workers. The role of subsidised employment programmes has decreased in importance in the reform. The working hours and institutional arrangements in the German labour market have moved into a more flexible direction during the last years. The aim is to make job placement more rapid and in 2004, personnel service agencies for temporary jobs were introduced as a part of this process.⁴¹

³⁸ Moderne Dienstleistungen am Arbeitsmarkt (2002).

³⁹ Koistinen (2003).

⁴⁰ The expression in German: “Eigenaktivitäten auslösen – Sicherheit einlösen”.

⁴¹ Deutsche Bundesbank (2004).

The real outcome of the German labour market policy remain yet to be seen in the coming years, but it is already now evident that many aspects or at least the directions of it have similarities with other countries' reforms. The new role for the PES, cooperation with the private sector actors and emphasis on employment services are found in the reforms of other countries as well.

3.6 Lessons from Different Reforms

To summarise this brief discussion on the labour market policy reforms in five countries, the main themes of the reforms are presented in the following table. The table is based on the interpretation of what is the most central point in each of the reforms.

Table 1. *Labour market policy reform characteristics in five countries*⁴²

	Denmark	Finland	Germany	Netherlands	UK
changes in unemployment benefits	X	(X)	X	X	(X)
role of the PES	X	X	X	(X)	X
activation policy	X	X		X	(X)
private actors			(X)	X	X
job-search issues	(X)	X			X
target groups:					
-youth	X	(X)	X	X	X
-elderly			X		
-long-term unemployed	X	X	X	X	(X)
-employers	X	X		X	
rights and obligations	X	X			(X)
new service models		X		X	X
working time / absence from work	X			X	(X)
cooperation with social partners	X	X	X	(X)	
connection to broader economic policy	X	X		X	
innovative characteristics	continued reforming, interconnection between ALMP, benefit reforms and flexible labour market	preventive active policies, dynamic job-search training, rapid decrease in structural unemployment	emphasis on lighter service methods in LMP, labour market information, job placement, preventive methods	PES is partially privatized, role of part-time work and benefit reforms work together	role of the PES is central and active which keeps also the costs for active programmes moderate, careful targeting of ALMP

All the reforms deal in different forms with unemployment benefits (strong feature in Denmark, Germany and the Netherlands), the role of the PES (especially Denmark and Finland), the youth (strongest feature in the UK) and the long-term unemployed. Also matters like activation policy and cooperation with social partners are usually present in labour market policy reforms. In most of the re-

⁴² For a more detailed comparison on the PES services in Denmark, UK, the Netherlands, Sweden and Finland, see Arnkil – Spangar – Nieminen (2001) or Arnkil (2004). “X” here refers to that the aspect in question is present in the LMP reforms, and “(X)” that it is present, but slightly.

forms the private actors' role (especially the Netherlands), job-search issues (the UK), the employers, the rights and obligations (Denmark and Finland), new service models (Finland, the Netherlands and the UK) and working-time or absence from work issues (Denmark and the Netherlands) and connection to broader economic policy are also relevant themes. Based on this table, there seems to be something in common and besides this, some national or occasional characteristics in the labour market policy reforms.

For a reform to become successful, a number of things must match with each other. The right timing, careful policy design and implementation are some of the relevant issues. How institutions work together and what is the motivation of the implementers, usually the PES personnel, to carry out effective changes in their work, is a good question. If a benefit regime will be changed or other basic limits to implementing are set on policy level, they affect the outcome, but it is highly important to consider carefully the implementation and conditions for it to achieve the targets.

4. Incentive Structure and Links to the Functioning of the Labour Market

This part of the paper discusses employment protection legislation, unemployment benefits and early retirement issues as well as their links to the functioning of the labour market.

4.1 Employment Protection Legislation

An overview of the employment protection legislation is based on summing up both regular and temporary employment protection. Besides these aspects, information on legislative aspects for the protection against collective dismissals has been developed by the OECD⁴³.

*Table 2. Strictness of employment protection legislation, sum variable (scores between 0-6)*⁴⁴

country	late 1980s	late 1990s	2003	change 2003-late 1990s
Austria	2.2	2.2	1.9	-0.3
Belgium	3.2	2.2	2.2	0.0
Czech Republik	n.a.	1.9	1.9	0.0
Denmark	2.3	1.4	1.4	0.0
Finland	2.3	2.1	2.0	-0.1
France	2.7	3.0	3.0	0.0
Germany	3.2	2.5	2.2	-0.3
Greece	3.6	3.5	2.8	-0.7
Hungary	n.a.	1.3	1.5	0.2
Ireland	0.9	0.9	1.1	0.2
Italy	3.6	2.7	1.9	-0.8
Netherlands	2.7	2.1	2.1	0.0
Norway	2.9	2.7	2.6	-0.1
Poland	n.a.	1.5	1.7	0.2
Portugal	4.1	3.7	3.5	-0.2
Slovak Republic	n.a.	2.4	1.9	-0.5
Spain	3.8	2.9	3.1	0.2
Sweden	3.5	2.2	2.2	0.0
Switzerland	1.1	1.1	1.1	0.0
United Kingdom	0.6	0.6	0.7	0.1

Source: OECD 2004, see also Nicoletti – Scarpetta – Boylaud (2000), 58-59, 72-73.

⁴³ Generally the protection indicator against collective dismissals gets higher scores than other forms of EPL. However, this is an additional form of protection and the requirements in most countries are quite modest. It seems reasonable to concentrate here in the main forms of EPL. (OECD 2004, 102, 117).

⁴⁴ The stringency of the employment protection legislation is based on 18 items on three main areas: 1) employment protection of regular workers against individual dismissal, 2) regulation of temporary employment and 3) specific requirements for collective dismissal (OECD 2004, 102). This indicator is based on the first two areas.

The general outcome for selected European countries from the late 1980s to the late 1990s is that most countries have eased employment protection regulations. Only France had stricter regulations in the late 1990s than in the late 1980s. Southern European countries with the most stringent legislation in these respects had all less legislative protection in the late 1990s than about a decade before. The United Kingdom and Ireland having the least legislative employment protection have not changed their general situation. The development in the last few years after a period of some kind of deregulation is more moderate: from the late 1990s to 2003, the strictness of employment protection legislation has practically remained the same in most countries with the most remarkable changes observed only for Italy and Greece, which countries now are closer to the legislative protection level of others. Of the Southern European countries also Portugal has further eased this legislation slightly, but Spain has moved a little into the opposite direction. Hungary and Poland seem to build protective legislation especially for temporary employment. In most of the other countries the main area of regulatory changes has occurred around temporary employment as well, but mostly into the opposite direction. Temporary work agencies used to be heavily regulated in the late 1980s, but in the next decade, the situation changed much. Also fixed-term contracts were less regulated in the late 1990s than ten years before. These kind of changes are not produced in isolation, but they are interconnected with other labour market developments, e.g. in the early 1990s the PES used to have a (practical) monopoly or otherwise a very strong position in many countries, but due to these legislative and other changes in the labour market, the situation is much more diverse and competitive at the moment.

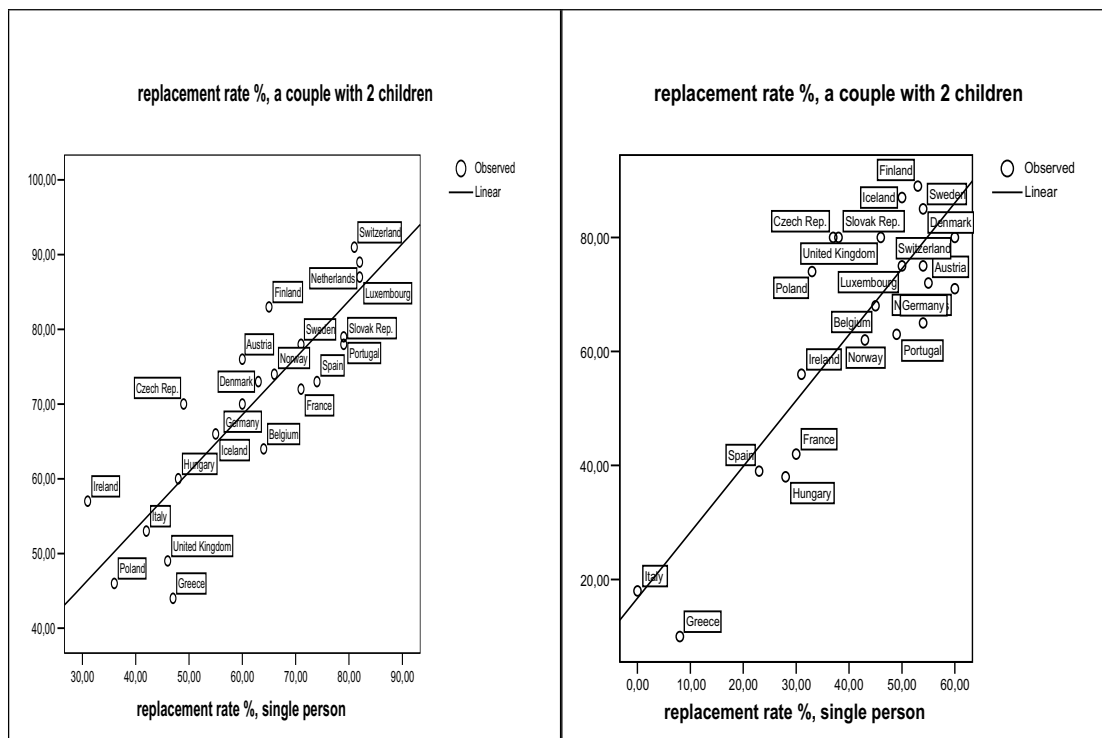
Considering the prospects from now on, it seems likely that after a period of some kind of deregulation in the 1990s, it will pause or slow down at least. The mean value for this sum variable for the above countries has gone down from the index level of 2.7 in the late 1980s to 2.1 in the late 1990s and further to 2.0 in 2003. What is important is that also the standard deviation between countries has become narrower from 1.1 in the late 1980s to 0.8 in the late 1990s and 0.7 in 2003, respectively. So, for the countries presented in table 2, the employment protection legislation is generally clearly more coherent (also convergent) between many European countries than it used to be before. The observed maximum level of protection by this kind of legislative means has been eased, but the minimum has remained practically the same. However, as this development is likely to be based on competitive aspects and the globalisation of the European economies, which has put more external pressure especially for the most protective countries, the protection levels from mobile workers' point of view in several European countries resemble each other at least very generally. Still, the differences between countries are relatively broad⁴⁵.

⁴⁵ Cluster combinations separately on the state and change of EPL indicate that for the state in 2003, high protection countries are France, Spain, Greece, Norway and Portugal, as low protection countries are

4.2 Unemployment Benefits

The unemployment benefit systems in several European countries consist of two parts: unemployment insurance and unemployment assistance. Besides these, social assistance and other related benefits like housing benefits may be payable at least partially because of unemployment. Two aspects of unemployment benefits are of main interest here: the replacement rate and the duration of the benefit.

Figure 10 a and b. Net replacement rates of unemployment benefits for two family types at APW wage levels at the start of a benefit period (a, left) and for long-term benefit recipients (b, right) in 1999⁴⁶.



Source: OECD 2002b.

Net replacement levels can be calculated for different representative family types and earning levels. Figure 10 a and b indicate that taking the cross-country mean

Ireland, Switzerland, Denmark, Hungary and the UK as the rest build the medium group (Italy, Slovak Rep., Austria, Czech Rep., Finland, Poland, Germany, Sweden, Belgium and the Netherlands). Between the late 1990s and 2003, remarkable deregulation has occurred in Greece and Italy, slight deregulation in Austria, Germany, Portugal and the Slovak Republic. as the rest of the countries have remained about the same (however, there exists a subcluster of Hungary, Poland, Ireland and Spain which countries have increased the strictness of EPL slightly).

⁴⁶ The dependency between a single person and a couple with two children at the start of the benefit period $Y=22.8+0.76X$, $r^2=76\%$, sig.*** (where Y =net replacement rate % for a couple with 2 children and X =for a single person) and after 60 months of benefits $Y=16.7+1.16X$, $r^2=72\%$, sig.***.

trend line, countries over the line are more “family-friendly” in case of unemployment than countries under the line⁴⁷. At the start of the unemployment period, the net replacement rates are generally higher than after 60 months of unemployment when unemployment insurance benefits have usually ceased to be payable⁴⁸. At the start of unemployment, the cross-country trend suggests that a 10 percentage point increase in net replacement rate for a single person would on average increase the net replacement rate for a couple with two children by 7.6 percentage points, but a similar change for single long-term beneficiaries would raise the replacement rate by 11.6 percentage points for a couple with two children. Now, it is possible to consider either that the governments become more family-friendly after really long unemployment duration or the other way round: that they set stricter rules for single persons. The answer can be found by studying the simple descriptive statistics.

Table 3. Descriptive statistics for net replacement rates for started unemployment or 60 months' duration, two family types at APW wage level in 1999

	mean	standard deviation	variance	variance coefficient
started, single	61.4	15.4	238.4	0.25
started, couple with 2 children	69.6	13.5	183.0	0.19
60 months, single	41.0	16.0	257.8	0.39
60 months, couple with 2 children	64.0	21.8	475.1	0.34

The tax-benefit systems for 22 European countries indicate that the unemployment-based net replacement rates for single persons become much stricter in the course of unemployment in relation to a couple with two children. This family-friendliness means also that there are hardly better economic incentives for job-finding for the family with children even with longer unemployment duration (but probably the social pressure is high as must be the economic pressure all the time even if the incentives do not change much in time), but for a single person, the incentives for job-finding become clearly better in time. Decision-makers seem to agree most on the benefit outcome for a family with children in the beginning of unemployment and the outcomes differ most for long-term unem-

⁴⁷ This argument is based on the idea that the net replacement rate for a single person could be interpreted here as some kind of yardstick of the unemployment benefit regime. However, this idea is open for criticism.

⁴⁸ 60 months of uninterrupted unemployment is an extreme case when the job-seekers usually are within a long distance from open labour market jobs, but the nature of the unemployment benefit system in this case can clearly be demonstrated.

ployed single persons. The systems produce a very different net replacement outcome for the long unemployment duration in various countries.⁴⁹

A further developed picture of the replacement rates applies the concept of the family purse income⁵⁰. The main difference in relation to the net replacement rates presented above is that housing costs are deducted from the disposable income, the idea behind this being that it is difficult to adjust housing costs in the short run at least. These calculations for seven countries show clearly lower replacement rates than those presented above⁵¹. Also various labour market mobility patterns are calculated from the incentives' point of view. Table 4 demonstrates that for a single person, re-employment even at clearly lower wage levels than before unemployment has high economic incentives.

Table 4. Unemployment and work re-entry at two wage levels, net replacement rates, single person, initially at APW wage level, year 2000

country	unemployment	work re-entry, 75 % wage	work re-entry, 90 % wage
Denmark	46	73	92
Finland	44	71	89
Italy	33	73	89
Netherlands	60	69	87
Spain	63	73	89
Sweden	55	67	86
United Kingdom	29	69	87

Source: Remain in or withdraw from the labour market (2003, 34).

Benefit duration is another important issue. It is not only the duration of unemployment insurance benefits which do matter as to the labour market outcome, but the whole system of unemployment benefits including unemployment assistance and related other benefits. Many European countries have special rules for the older workers, which can be seen both from the point of view of social protection of this group of people or as a disincentive for re-employment in relation to the younger people. It is also common that unemployment assistance following the usually earnings-related insurance benefits of limited duration, has no limits for the maximum duration. That being the case, it is relevant how job offers and active labour market policy measures are provided and how the avail-

⁴⁹ These results should be interpreted with caution, as this kind of "system outcome" especially for longer unemployment durations is much dependent on the implementation of work-tests and other kind of means-testing of the relevant benefits. The real incidence of long-term unemployment also differs heavily between countries.

⁵⁰ The calculation of family purse income is based on gross wage or gross benefit, income taxes and employee's social security contributions are deducted and cash child allowances, housing allowances and possible topping-up of social assistance added which equals disposable income. After that, housing costs are deducted and the result is family purse income. (Remain in or withdraw from the labour market (2003, 19).

⁵¹ The difference is mainly explained by the housing costs.

ability for the labour market is tested. Comparison of the development from 1999 to 2004 does not indicate any major changes in maximum durations: some stricter limits have been introduced in three countries and other three have extended periods. For the assistance benefits, they have mostly remained the same⁵².

Unemployment benefit systems seem to compensate the economic losses due to loss of job with relatively satisfactory net replacement levels in relation to the income from work at least in the beginning of the unemployment period. The replacement levels usually drop clearly for single persons, but the cross-country mean after 60 months of unemployment for a couple with two children remains almost at the same level as in the beginning of unemployment. Unemployment benefits have both positive and negative effects on the labour market and they do not operate in isolation, but rather in interconnection with other benefits and labour market institutions. Empirical research findings could be concluded in such a way that generous unemployment benefits of long duration tend to increase structural unemployment. If the benefits are generous in the beginning of the unemployment period and less generous later, this may, on the one hand, create incentives for good matches and intensified job-search, but on the other, also false incentives for both employees and employers to agree on temporary layoffs or dismissals⁵³.

4.3 Early Retirement Schemes

Early retirement schemes for labour market reasons are important for the way the labour market functions. They provide a possibility for elderly workers e.g. with disability or long benefit periods behind them to get a decent social security in a situation where continuing in work or re-employment is often very difficult. However, the design of these schemes may be decisive whether they just meet the ultimate goal of providing social security or turn out to produce peculiarities in the labour market⁵⁴. One of the main questions is, whether these schemes reduce labour supply by providing possibilities for social security as an alternative to continuing in work or returning back to work.

In France, e.g. end-career unemployment is less well-regarded than early retirement, also the net replacement rate for early retirement schemes is around 75 per cent compared with about 65 per cent for unemployment at average wage levels. There are also differences in this respect between the public and private sectors

⁵² OECD (2002b), European Commission (2004).

⁵³ Structural Rigidities in Europe (2002, 18-21).

⁵⁴ Kyyrä and Wilke (2004) prove with Finnish microdata that the raise in age limit in an extended unemployment benefit system for the elderly long-term unemployed leading to pension dropped also the risk of unemployment in the target group on a level comparative with that of others who could not benefit from this system.

and further in the private sector within companies of varying size. Blue-collar workers in the public sector usually retire as they quit working, as in the private sector the end-career takes place often with unemployment or early retirement channels. Especially in small companies, the risk of unemployment is higher.⁵⁵

Table 5. Net replacement levels for early retirement routes for different family types at APW wage level in selected countries⁵⁶

country	single person aged around 60	one-earner couple aged around 60	two-earner couple aged around 60, both in early retirement
Denmark	42	47 (I) 69 (II)	50
Finland:			
-Early Retirement	47	60	57
-Unempl. Pension	48	60	58
Italy	70	75	70
Netherlands	72	77	73
Spain	63	61	61
Sweden	47	47 (I) 80 (II)	51
United Kingdom	37	48	40

Source: Remain in or withdraw from the labour market? (2003, 55-68).

Net replacement levels in early retirement schemes are higher in relation to unemployment benefits in Italy, the Netherlands, Finland and the United Kingdom. In Spain there is no difference and in Denmark and Sweden it is the other way round. It is in some cases possible that people can make a choice between the benefit systems and even in the disappearance of this option, the schemes may have an effect on the labour market behaviour of the individuals. It is often reasonable to consider early retirement to be a selection of both spouses.

A comparative study on early retirement in Denmark and Finland shows that planning of early exit from employment is common in both countries, but more common in Denmark, where 70 per cent planned to exit employment before statutory retirement age as in Finland 52 per cent planned early exit⁵⁷. It is interesting to note that the actual early retirement, however, is less common in Denmark than in Finland, which may be a result of more voluntary channels to the early exit than in Finland. In Denmark it seems that the most qualified aged em-

⁵⁵ Brocas – von Lennep (2002, 39-40).

⁵⁶ In Finland two schemes can be used for early retirement for the time being. The first one is old age pension, which is possible to enter from employment or unemployment. The other is unemployment pension, which can be entered only through long-term unemployment (this scheme will be phased out gradually between 2009 and 2014). In one-earner couple Denmark I is for the case where the dependent spouse is not available for the labour market, Denmark II when the spouse is available. Sweden I stands for the case where the earner receives pension (this is the case also for Finland), Sweden II where both receive pension.

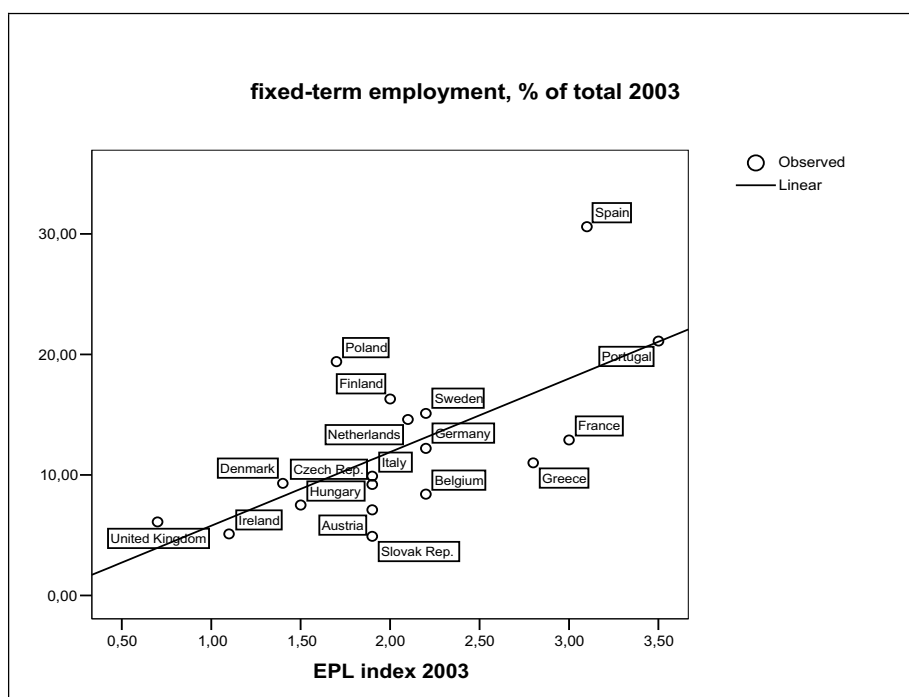
⁵⁷ Part of the difference may be explained, however, because of the statutory retirement age is higher in Denmark than in Finland.

ployees remain in the labour force and the less qualified find a way of early exit. In Finland those aged employed who are not planning early exit have less work-related stress, and ordinary disability pensioners and unemployment pensioners have lower resources in terms of education and health than the aged employed⁵⁸.

4.4 Interconnections between Incentives and the Functioning of the Labour Market

This part tries to find out what kind of interconnection there exists between the incentive structures and the way the labour market functions. The observed connections are of a very preliminary character and based on two variables at time.

Figure 11. Dependency between the strictness of Employment protection legislation and the share of fixed-term job contracts in 2003⁵⁹



Sources: OECD 2004, Employment in Europe 2004.

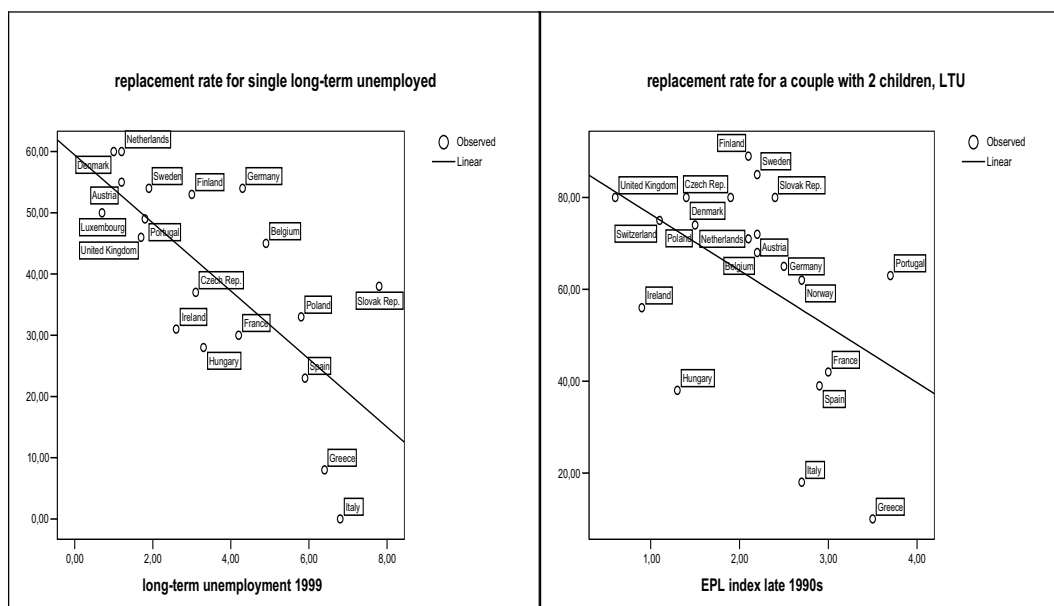
Some interesting interconnections between the relevant variables can be found. The increase in the general strictness of the employment protection legislation seems to be connected with some kind of increase in the share of fixed-term employment of total employment as cross-country trend is concerned. This outcome is found for the year 2003 based on 18 European countries. A possible interpretation is that strict employment protection legislation seems to make the labour

⁵⁸ Saurama (2004, 105-7, 211-2).

⁵⁹ Correlation between EPL index and the share of fixed-term contracts is 0.66, sig.**, N=18.

market to react in such a way as to especially lower the risk of wrong hiring decisions through increase in fixed-term contracts⁶⁰.

Figure 12 a and b. Dependency between long-term unemployment and replacement rate for single long-term unemployed person in 1999 (a, left) and EPL index in late 1990s and replacement rate for a couple with 2 children, long-term unemployed, in 1999 (b, right)⁶¹



Sources: OECD 2004, Employment in Europe 2004.

Also, the EPL strictness and labour market dynamics seem to be interconnected: the correlations between inflows into unemployment and EPL, on the one hand, and outflows from unemployment and EPL, on the other, have both negative and significant correlations. Employment protection legislation seems to protect existing jobs (and limit the inflow into unemployment), but at the same time reduce the re-employment chances of unemployed job-seekers.⁶² Putting this in a very straightforward way, EPL is likely to improve the security for the employed, but also likely to reduce the labour market flexibility necessary for the unemployed to get jobs. However, it is important to keep in mind that EPL in itself does not solely determine the labour market outcome, but the policy regime and its interconnection with the labour market as a whole. Besides this outcome, there is a

⁶⁰ Compared with the more focused results of EPL on permanent contracts and, on the one hand, incidence of temporary work and, on the other, transition rate from fixed-term to permanent employment in OECD (2004, 87), the correlation here is much stronger and has higher significance.

⁶¹ Correlation between long-term unemployment rate and net replacement rate for single long-term unemployed person is -0.72, sig. **, N=19, correlation between EPL index in the late 1990s and net replacement rate for a couple with 2 children, long-term unemployed in 1999 is -.46, sig. *, N=20.

⁶² OECD (2004, 63, 77).

slight indication of trade-off between the strictness of EPL legislation and the net replacement rates for long-term unemployed beneficiaries.

The net replacement rate of unemployment benefits for a single long-term unemployed person and the incidence of long-term unemployment as a share of the labour force have an interesting interconnection. This negative dependency is found for the year 1999 where the latest replacement rates for these 19 countries were available. A possible interpretation for this trade-off is that a high replacement rate for the long-term unemployed beneficiaries is economically possible only in countries where the labour market function so well that the incidence of long-term unemployment remains relatively limited. The Netherlands, Denmark and Austria having the most generous unemployment benefit regime in this respect have also the lowest long-term unemployment incidence (except the case for Luxembourg) among these 19 European countries. This interpretation is supported by high (from 0.67 to 0.73) and significant positive correlations between full-time equivalent employment rates (this means in practice high female participation in the labour market) and replacement rates for all three variables describing replacement rates for long-term unemployment.

As the differences across countries in Europe are broad and all preliminary interpretations are based on trend lines across countries, it is important to emphasize the solid functioning of the labour market and the relevant benefit regime and legislative regulations concerning the labour market as a whole, not only one aspect at a time. If the labour market is dynamic, unemployment relatively limited and employment rates for both sexes are high, it is possible to have a high level of social protection. If the labour market is not dynamic and the relevant flexibility mechanisms are missing, the social protection systems may turn out to become rigidities in the labour market and a hindrance for re-employment.

5. Conclusions and Policy Considerations

Some conclusive discussion is needed, even if the data in this kind of analysis is not satisfactory and the analysis remains really an overview not going into deeper or more focused studies. The results of this paper are based mainly on those European countries where somehow comparable data has been available. Despite all uncertainties and limitations, some really interesting and relevant outcome and conclusions can be summarized.

5.1 Overall Labour Market Development

In the last ten years, some countries have been able to improve their employment rates for over 10 percentage points and the cuts in the unemployment rates have also been really remarkable. The development from 1999 to 2004 is, however, more modest in a number of countries. There has been a tendency of weakening male employment rates, but just the opposite for the female employment. This outcome is dependent on several factors like the general economic environment and the labour demand, the supply of qualified workforce and the functioning of the labour market. Some, but not adequate discussion on these aspects is provided under by the features of the labour market policy reforms, the benefit regime and regulations concerning the labour market.

There exist high dispersion of employment and unemployment across countries. Female labour market participation is rising, which is an important factor for many societies in several respects, like the social security, taxation systems and working-time issues. The full-time equivalent employment rate is a good indicator for how much work the working-age population does and does show remarkable differences across countries. Taking the variance in working-time patterns into account, the full-time equivalent employment rate is becoming a more important indicator putting all kinds of work efforts into one variable.

The development in employment during the last five years for the aged has been good, but quite the opposite for the youth. There seems to exist much room for improvement in many European countries in the employment patterns for people with less than upper secondary education, young people aged 15-24, those aged 55-64 and females. For the youth, there is usually a clear trade-off between education and at least full-time employment. There is not especially promising room for improvement for the highly educated, the prime-age people and for males. It is important for the policy-makers to note that any improvements in the employment record of these groups also mean most in terms of general employment rise in many countries. Productivity is of vital importance in gaining welfare in the longer run, but for the equality of the members of the European societies there is

a high interest in improving the situation of the most vulnerable groups. This is also in the best interest of the balance of the public economies.

5.2 Selected Labour Market Policy Reforms

Labour market policy cannot solely solve labour market problems like causing a general decrease in unemployment or increase in employment, but it can contribute to the functioning of the labour market and take good care of certain more specific labour market problems and target groups. Selection of five different labour market policy reforms carried through or just being implemented in Denmark, Finland, Germany, the Netherlands and the United Kingdom represent also more broadly many of the important themes which have been addressed in labour market policy reforms in several countries. Some of these reform ideas have been interconnected across countries and have turned out to produce remarkable results in labour market performance. Often these kind of good achievements in cutting unemployment or increasing the employability of certain groups of people are a result of simultaneous broader policy reforms, but the role of labour market policy should not be regarded as insufficient.

The role of combining benefit reforms, PES organisation changes and activation policies at least for certain target groups is an important common theme in the successful reforms. Preventive policies in order to prevent unemployment prolongation and enhance the good quality matching of labour demand and supply at an early stage of job-search period and the vacancy period should be emphasised. As preventive policies works, the inflow into long-term and structural unemployment decreases and the stocks become more limited.

Probably a new active role for the Public Employment Service, working even with lighter methods, information and employment services for both the job-seekers and employers and effective job-search support instead of large-scale active programmes, is becoming more and more important. Budget restrictions emphasise further the role of lighter and more preventive services, which have been present on several reform agendas already.

The time horizon of the reforms is often a problem. Politicians expect results rapidly, but major reforms cannot even be thoroughly evaluated in a couple of years. Implementation issues are one of the most decisive factors behind good reforms. It may be easier for the implementers to adopt certain new policy lines if the reform is implemented like a continuum in several phases. Many interesting national or occasional characteristics still exist and these should not be underestimated in assessing the policies. Labour market policy reforms also have well established connections to other institutional arrangements like various benefit changes and these may turn out to be important alternative options for certain people and form a precondition for success of the LMP reforms.

5.3 Regulations and Benefits

Labour market regulation should not be discussed isolated from other institutional characteristics and the policy regime as a whole, but in interconnection with these arrangements. It is not only e.g. the employment protection legislation (EPL) as such, but the overall regime, the role of benefits and the functioning of the labour market that matters for the labour market outcome.

In EPL, after a period of deregulation in the 1990s, more moderate development is now going on and more convergent development is to be expected in the coming years. Despite the tendency of some convergence, outliers can possibly cause problems if the labour market and the product market become more integrated due to international economic behaviour of companies and citizens.

The net replacement rates of unemployment benefits differ widely across countries. The governments seem to agree most on the treatment of family breadwinners in case of unemployment and much less on the treatment of single persons. For long-term beneficiaries, the replacement rates drop heavily for single persons, but for families with children, there are possible incentive problems as the net replacement rates do not seem to drop in time. The early exit routes differ also from country to country: also the unemployment route or the early retirement route produce varying order of net replacement depending on the country in question.

5.4 Policy Considerations

There is still much room for improvement in almost any of the European countries in labour market performance. Especially, the population with lowest employment rates has still much to expect from policy makers. The development of the service sector, education and skills needs improvement. There is also a need for clearly better integration of those people who are at the moment excluded from the labour market. Simultaneous tax-benefit and labour market policy reforms and the balance between other regulations, like the employment protection legislation may turn out to produce better jobs for more people. It is highly important that the relevant policy changes are discussed in interconnection with each other and not in isolation, as the modern labour market is a diverse structure with several behavioural effects following from separate changes. It is worth mentioning that as security and flexibility elements of the labour market are concerned, the labour market policy can possibly to certain extent substitute the deregulation of the employment protection legislation by increased activation measures. More active labour market policy is also important as most of the resources are still devoted to the passive income support. The passive labour market policies should also have a good interconnection with the active policies so

that they together can improve the functioning of the labour market and re-employment of the job-seekers.

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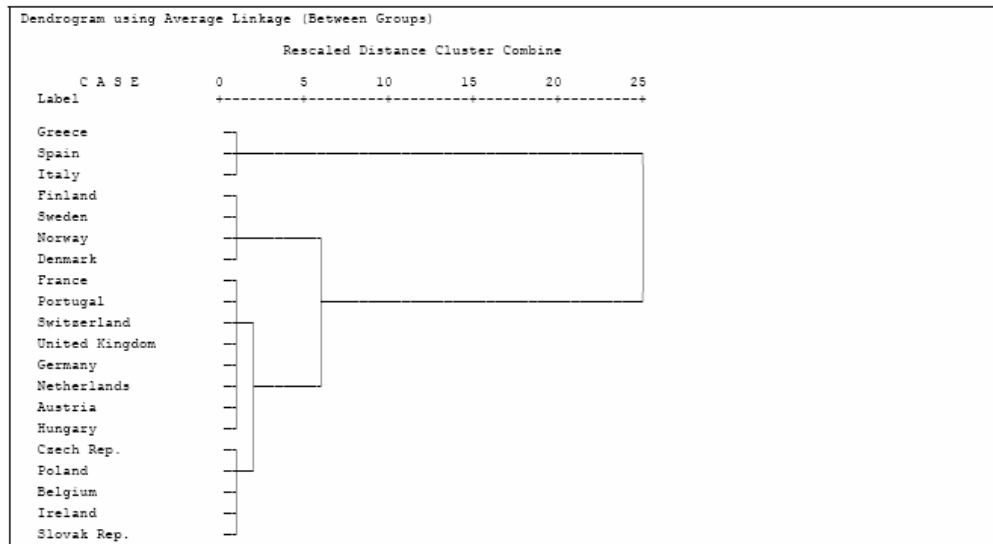
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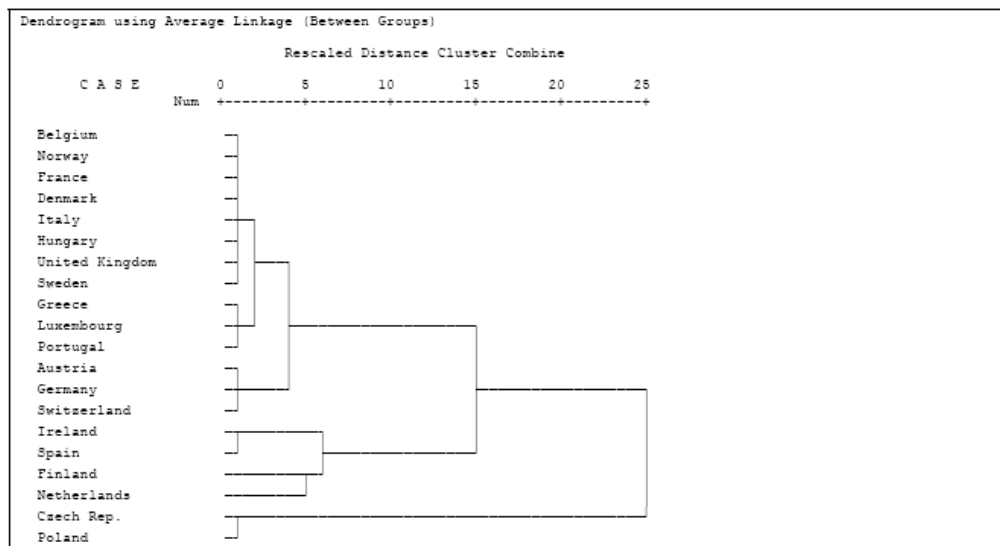
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Appendix

Cluster combination based on employment rates and unemployment rates for men and women in 2002 and 2003 (state of the labour market).



Cluster combination based on employment rate and unemployment rate change in 1994-2003 (labour market change).



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