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UNEMPLOYMENT AND LABOR MARKET POLICIES IN GREECE

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Abstract

The aim of this paper is, by focusing on the Greek experience, to examine the long-term evolution of unemployment and to offer an explanation for the nature and causes of unemployment. Analyzing the pattern of the Beveridge curve, it is observed an outward shift of the unemployment-vacancy relation which is attributable to changing macroeconomic policies and institutional structures throughout the last decade. A model that tests the effects of the various labour market policies on the growth of the unemployment rate is presented. Active labor market programs appear to be of minor importance in combating unemployment. Instead, unemployment growth is found to be sensitive to variations in unemployment insurance expenditures. Finally, an empirical test of the alternative hypothesis of the real wage gap does not provide evidence in favour of the claim that excessive real wages are a major cause of increasing unemployment. (JEL: J60)

1. Introduction

Taking advantage of the dynamic effects of the rapid expansion of world trade, Greece achieved impressive GDP, productivity, and export growth records up to the early 1970s. The economy experienced a feeble growth in the rest of the decade. After the second oil crisis, however, the Greek economy stagnated. It failed to adjust its production structures and it was unable to reap the full benefits of joining the European Community (EC). The decline in economic growth has been more accentuated than in many other EC countries and the inflation rate has been extremely high compared both with the period prior to the mid-1970s and with the rate for Greece's European trade partners. Postwar unemployment follows a similar pattern. Up until the beginning of the 1980s the unemployment rate remains at low levels. Since then it starts to drift upward structurally.

Even though high levels of unemployment accumulate tremendous economic and social costs to society (Blaug, 1993: 396-99), so far this issue has been

practically neglected by politicians and scholars. Instead, public concern concentrates on the budget deficit-inflation nexus, and economic policy since the mid-1980s has assigned much greater priority to the battle against inflation than to the battle against unemployment. As inflation rates drop, while unemployment continues to be extremely high by historical standards, the latter emerges as a central economic problem. Th aim of this paper is, by focusing on the Greek experience, to examine the long-term pattern of unemployment and to offer some explanations for the nature and causes of unemployment.

In Section 21 present data on unemployment and relate historical events to unemployment interwoven with changing policy views and institutional structures. To this end I apply a framework that is based on the simultaneous existence of unemployment and job vacancies, and the equilibrium relation which holds between them, widely known as the Beveridge (UV) curve (Blanchard and Diamond, 1989; Jackman, Pissaridis, and Savouri, 1990). I show that the marked shifts of the UV curve throughout the 1980s are attributable to institutional changes that have occured in the Greek economy.

In Section 3 an empirical model of the unemployment rate is provided in order to support my main argument about the structural character of Greek unemployment and to assess the role of various labor market policies. Next, the validity for the Greek case of the popular hypothesis of the real wage gap is empirically tested. Measuring the sensitivity of unemployment rates to real wage gaps, I do not find a significant effect. In the final section conclusions are drawn on the nature and causes of unemployment, and on the policy implications of the analysis.

2. The evolution of Unemployment in Greece

In Figure 1 the Greek unemployment rate is compared with the average European Union rate[1]. The Greek rate decreases in the 1960s. It remains quite close to the European Union average in the late 1960s and in the early 1970s. After the first oil crisis, the Greek experience is different from that of its European trade partners. The increasing trend of the Greek indicator is less steep than the European one up until the beginning of the 1980s. Since then the Greek unemployment rate has been sharply increasing. On the other hand, the European Union seems to experience a modest recovery during the second half of the 1980s, whereas it is again on an upward trend in the early 1990s.

Greek unemployment, as is shown in Figure 1, has become a serious prob-

lem since the early 1980s. Before that it was kept at low levels thanks to two major developments: rapid industrialization and massive emigration. First, sustained economic growth took place, made possible by the high GDP growth of 6.3 per cent yearly between 1954 and 1979. It is worth noting that Greek per capita GDP jumped from one quarter of the OECD average in the mid-1950s to almost one half in 1979 (OECD, 1993:12). Apparently, the observed downward trend of the unemployment rate is consistent with the long process of postwar industrialization which culminated in the early 1970s (Mihail, 1993). Second, industrial investment and modernization of the agricultural sector impressively raised labor productivity. In the business sector of the economy, in the 1960-1973 period, the average growth rate of output per employee reached 8.8 per cent considerably exceeding the corresponding rate (5 per cent) for OECD European countries (OECD, 1992:151), while in agriculture it more than tripled (Katsanevas, 1984: 63). Rising productivity generated labor redundancies, especially in agriculture. This, coupled with the existence of significant wage differentials between the advanced countries and Greece[2], and labor shortages in Western Europe at that time, led to massive emigration. The total number of emigrants for the 1955-1971 period represented 25.4 per cent of the economically active population in 1971. Not surprisingly, two-thirds of the emigrants came from agricultural areas and 80 per cent were in the economically active age group of 14-44 year-olds (Centre of Planning and Economic Research, 1976:33).

In order to explain the upswing in unemployment I use an approach based on the vacancy - unemployment relationship, the Beveridge curve. Figure 2 shows the Greek Beveridge curve that traces combinations of the job vacany rate (the number of job vacancies over the labor force) and the rate of registered unemployment[3]. A look at the UV curve suggests that two types of major shifts over the 1974-1991 period have taken place. The first one, which started in 1974 and terminated in 1983, is characterized by a long-term downward shift of the vacancy supply (VS) curve. This curve traces out combinations of unemployment and vacancies. The two variables move in the same direction, the rationale being that high unemployment rates tend to reduce wages, thereby encouraging firms to post more job vacancies (Jackman, Pissarides, and Savouri, 1990: 458-466). In our case the observed permanent shock is attributable to the emergence of an extremely militant labor movement (after the restoration of democracy in 1974) which bargained effectively for higher wage rates. Indeed, after 1974 strike activity (measured as the ratio of days lost in strikes to total hours of employment) soared, reaching unprecedented levels in the early 1980s (Mihail, 1993: 292-294). The high frequency of industrial conflicts in manufacturing, an empirical proxy of the bargaining aggressiveness of the trade unions, more than

doubled in 1976-1981 compared to 1962-1966 (Ioannou, 1992: 28). A notable feature of this period was that labor organized effectively at local plant level pursued informal decentralized bargaining with management and achieved substantial wage increases in a phase of deepening economic crisis. Between 1974 and 1983 wages and salaries in the non-agricultural sector grew at an annual rate of 5.7 per cent, whereas fixed investment decreased at an annual rate of 1.8 per cent. Moreover, during the period of peak disinvestment (1980-1983), when the average real investment rate decreased by 7.5 per cent, wage and salary earners managed to receive an average pay increase of 2 per cent in real terms . Hence, observing the economy's path along the UV curve from 1974 to 1983, it is reasonable to relate rising union bargaining power and erratic wage rounds to a severe fall in the vacancy rate and a sustained higher unemployment rate.

In the first half of the 1980s the Greek economy was caught in a vicious circle of stagflation associated with deindustrialization (Mihail, 1989), rising balance-of-payments tensions and increasing external debt-servicing costs. In the mid-1980s the economy entered a period of adjustment underpinned by a tightening of macroeconomic policies and escalation of structural reforms with the aim of preparing the ground for Greece's full participation in the process of EC monetary and economic union. I maintain that this lasting restrictive macroeconomic policy stance and certain institutional reforms gave the business sector the incentive to "shake out" unproductive labor. This development is mirrored in the rightward shift of the UV curve over the 1984-1991 period.

All the governments of the last ten years, with the exception of the 1988-1989 pre-electoral period, sought to reverse the rapid development of macroeconomic imbalances by implementing economic stabilization policies and adjustment programs. Reflecting the growing weight of ailing firms (one quarter of corporate industrial establishments, most of which are under state control), the restoration of profitability and industrial restructuring have been the primary target of the governments' institutional reforms (OECD, 1993:20). To this end, the financial system underwent an extensive liberalization process, labor market rigidities have been gradually relaxed through far-reaching institutional measures followed by public sector consolidation and radical deregulation in goods and services markets (OECD, 1990; OECD, 1991). After 1984 a very strict system of lay-offs was considerably eased. In addition, the deregulation of markets, which progressively prevented government protection for ailing and inefficient firms, led to the closure of an increasing number of firms. These developments tended to moderate labor union militancy, to improve labor-management relations in the private sector and virtually limit strikes to only

public utilities and state-controlled banks (OECD, 1993: 15-16). The emerging new institutional setting, mirrored in deregulated markets and external trade liberalization, has been encouraging industrial restructuring by deepening the dual character of the economy. It should be noted that the Greek business sector is composed of two distinct sub-groups: highly profitable private establishments, and ailing (mainly state-controlled) firms. The ratio in the first half of the 1980s was less than two to one. This ratio is now about three to one, a remarkable improvement marking the industrial restructuring process[5]. The situation is expected to improve further since almost all heavy loss-making firms are state-controlled[6] and the privatization program will not allow them to maintain their present form. At the same time, many of the dynamic firms, especially the large ones, have managed to raise venture capital, to develop links with foreign firms and to maintain high self-financing ratios, enabling them to invest heavily in modernization throughout the 1980s. Investment in new technologies, however, needs fewer but more highly skilled operatives, thereby creating unemployment among unskilled and semi-skilled employees. In a recent survey for Northern Greek industry the intensifying effort to achieve industrial adjustment via flexible automation has led to a changing composition in the skills required of the labor force by employers, which in turn, has reduced employment by 6.8 per cent (Koufidou and Mihail, 1994)[7]. Apparently, the unemployment induced by the skill shortages has been exacerbated by massive lay-offs in ailing firms[8].

After the economy's structural shock, the new labor market conditions, characterized by unprecedentedly high rates of job vacancies and unemployment, are illustrated by the pattern of the UV curve in the early 1990s. Moreover, the persistence of high unemployment rates could be suggestive of hysteresis effects; the sharp rise in unemployment adversely affects the duration of unemployment, in this case, unemployment breeds unemployment. One could argue for the Greek case that the internal reorganization of firm generated redundancies and through a sorting process transformed the unemployed with non-competitive characteristics into long-term unemployed[9]. Official data are indicative of a sharp deterionation in long-term unemployment. Indeed, the share of long-term unemployed (people being unemployed for 12 months or more) in total unemployment, while it was around 20 per cent in the early 1980s, it has been soaring to 50 per cent in the 1990s.

Nevertheless, I think it is premature to argue persuasively for the existence of hysteresis in the Greek case. Up to this point one simply cannot reach any definite conclusion about the sources of the soaring long-term unemployment because the economic austerity programs have been carried out throughout the

last decade[10]. Demand has been slack throughout this period and I have not yet had the opportunity to examine the evolution of long-term unemployment during a sustained period of economic recovery.

3. Hypotheses and empirical results

3.1. The role of labor market policies

The UV curve is conditioned by numerous institutional arrangements, however, I concentrate on those which are pertinent to labor markets and presumably directly affect unemployment. In postwar Greece labor market policies aimed at combating unemployment have been carried out within an embryonic welfare system. During the 1950s and 1960s the main emphasis was placed on supporting the unemployment with unemployment insurance funds, while active labor market programs were practically restricted to labor market training. In response, however, to the problems that had been developing in the Greek economy since the mid-1970s, and in order to counteract increases in unemployment, active labor market policies were gradually developed. By far the greatest share of the expenditure for active programs has been devoted to placement services, labor market training, and (since 1983) to subsidizing employers in the private sector to hire unemployed people. Labor market policies can affect the unemployment-vacancy relationship. The argument is that placement services and training programs are expected to raise the search effectiveness of unemployed people and imporve matching probabilities by facilitating the adjustment of job seekers' skills to demand, while employment subsidies increase the supply of jobs at given wage rates. Based on this rationale, I hypothesize that the policies under consideration favorably affect the UV curve and tend to shift it towards the origin. On the other hand, the cash support principle has been permanently underlying the formal labor market network during the whole postwar period. There are reasons that lead one to expect that unemployment allowances can influence in an adverse manner unemployment. An increase in unemployment insurance funds, other things being equal, tends to reduce the cost of job loss for the worker. This enhances the bargaining position of both the job-seekers and the trade unions in negotiating their wage rates. In addition, it allows the former to reduce their search intensity. Therefore, increasing unemployment allowances are expected to raise unemployment either by increasing wage rates at a given vacancy rate or by reducing the job finding rate.

A simple model is estimated in order to assess the impact of active and

passive labor market policies on the unemployment rate. In capturing the effects of active policies, I construct variables that account for the relevant policy expenditures per unemployed worker. In addition, the overall impact of the active programs is approximated by summing up all the relevant expenditures per unemployed worker. Variations in the unemployment insurance scheme are captured by the ratio of the unemployed allowances to the wage and salary bill. Hence, I regress the registered unemployment rate on a set of policy variables, on the vacancy rate, and on the unemployment rate lagged by one year -its coefficient being considered as a measure of persistence. The regression equations were fitted for 1974-1991. The estimation period is limited by the availability of annual data series for our variables[11].

Table 1 reports the results of the estimated regressions. All the variables in the alternative specifications have the expected signs and are significant at the 5 per cent level (on a one-tailed test) with the exception of the composite variable of active policies and the placement services variable. The vacancy-unemployment relation slopes downwards and pesristence is excibited across all the specifications. The adjusted coefficients of determination are respectable, indicating that all the equations account for at least 95% of the total variation in the dependent variable. The Breusch-Godfrey (BG) test provides no indication of autocorrelated error terms at the 5 per cent level. The residuals are normally distributed according to the Jarque-Bera (JB) test. The ARCH test for heteroscedasticity is insignificant. We apply the Chow test (S) to test the structural stability of the relationships, and the forecast version of the Chow test (F) to assess the predictive performance of the alternative equations. The estimated regressions succesfully pass both tests.

In brief, what emerges from the empirical analysis is the persistent character of unemployment. This supports the main argument in the analysis of the pattern of the UV curve presented in the previous section. Active labor market policies are not found to be effective in combating unemployment. The ineffectiveness of these policies is not surprising; it actually underscores the embryonic state of the welfare system in Greece. Indeed, figure 3 shows that during an era of soaring unemployment the resources devoted to active labor market programs per unemployed worker have been declining.

In contrast, a decreasing cost of job loss, reflected in variations in the income replacement variable, seems to shift the Beveridge curve outwatds. The mechanism, through which unemployment insurance benefits tend to aggravate the unemployment problem is not clear. Based on the analysis of the previous

section, it would be more plausible to attribute its adverse effect to a depressing job-finding rate rather than to rising wage rates. This seems to hold true particularly during the second half of the 1980s and the early 1990s when restrictive macroeconomic policies, suppressing real wages, coexisted with increasing unemployment. Nevertheless, the association between increases in real wages and rising unemployment needs to be examined closer, since it has been stressed by a number of economists as well as by the OECD.

3.2. The real wage gap hypothesis

It has been maintained that in several advanced countries excessive real wage rates were the major cause of the unemployment increases after the first oil crisis (Bruno and Sachs, 1985; Bruno, 1986; OECD, 1989). This relationship has been tested by devising an indicator of the real wage gap which reflects the difference between the actual level of real labor costs and the warranted level. The warranted labor cost changes are dependent on changes in labor productivity and changes in the terms of trade. Slightly modifying Korpi's relevant model specification (1991: 320), I test the real wage gap hypothesis in the Greek case. I estimate through the Ordinary Least Square method, for the period 1963-1991, the following regression equation:

$$\Delta U = 0.005 + 1.03E - 06(\Delta WG)_{-1} - 1.008(\Delta P)_{-1} - 0.004(\Delta TT)_{-1} - 0.093(\Delta CU)$$

$$(2.827) \quad (0.013) \qquad (2.191) \qquad (0.179) \qquad (1.648)$$

$Adj.R^2 = 0.22$, BG $X^2(2) = 0.85$, ARCH $X^2(2) = 0.05$, JB = 0.57

Chow(S, 1974) = 1.47, Chow (S, 1984) = 0.55, Chow (F, 1989) = 0.38

Numbers in parentheses are the absolute values of t-statistics where

U = unemployment rate
WG = real wage gap (see Appendix)
P = labor productivity (real GDP per person employed)
TT = terms of trade
CU = capacity utilization ratio (reflecting aggregate demand conditions)
Δ = first difference operator

The equation displays good statistical properties passing the relevant tests for serial correlation, heteroscedasticity, normality, and structural stability. The

estimation results reported above show that all the coefficients have the expected signs, but they are insignificantly different from zero at the 5 per cent level with the exception of the productivity indicator. The significant positive intercept indicates that the independent variables of the equation cannot fully account for the upswing in the unemployment rate. These results are similar to those in Korpi's estimations for eighteen OECD countries (excluding Greece). Unwarranted increases in real wages, reflecting the rising union power in the period 1974-1984, are likely to precipitate the deindustrialization process and have an impact on unemployment. This, however, is not the case since the mid-1980s when real labor earnings have been declining (OECD, 1991: 48). Actually, the evolution of labor costs during the era of high unemployment favored Greek firms vis-a-vis the OECD trading partners. In the business sector relative wage levels, in common currency, declined from 55-56 per cent of the OECD and EC averages in 1979-1980 to 42-45 per cent in 1990-1991 (OECD, 1993: 28-29). It is rather the pressing problem of declining productivity[12] and the related industrial restructuring, mirrored in the outward shift of the UV curve, which are the main sources of the high unemployment rates.

4. Conclusions

For almost fifteen years now, Greek unemployment has been deteriorating indicating a significant underutilization o human resources. The main point of the analysis is that unemployment in Greece is structural. This conclusion has emerged by focusing on the sources of shocks in the economy, within a Beveridge curve framework. The initial rise in unemployment persisted in the second half of the 1970s and in the early 1980s because of shocks related to the union power after the fall of the dictatorship. The unemployment problem has considerably worsened since then. This development was mainly attributable to the repercussions of the deindustrialization process: business failures and required industrial adjustment. The econometric analysis could not find evidence in favor of the effectiveness of active labor market policies in combating the scourge of unemployment. This, however, was expected, given the embryonic state of the country's welfare system.

Nevertheless, I think that the structural character of unemployment points to a need for appropriately designed and intensified active labor market programs. Industrial restructuring is an ongoing process and high unemployment is heavily concentrated among unskilled workers. There is evidence of an increasing mismatch between the skill compositions of labor supply and demand, the

latter containing a declining proportion of unskilled jobs due to the internal reoganization of firms. These considerations primarily justify investment in labor market training programs. They also justify funds transfers from passive labor market programs to placement services aimed at improving the job finding rate. On the whole, I believe that well-targeted active policies should be put forward to counter the persistence of unemployment by speeding up adjustment in the labor market.

Appendix

The real wage gap variable WG is defined as follows (Korpi, 1991: 347):

$$WG = (RW + NWLC) - (P + TTEFF)$$

where

RW = real average compensation per employee in the total economy
NWLC = non-wage labor costs, consisting of employer's social security contributions per employee
P = Gross Domestic Product per employed person
TTEFF = terms of trade effect on national income

$$TTEFF_t = (dP_x\, X_{t-1} - dP_m\, M_{t-1}) \,/\, GDP$$

where Xt-i, M_t-i = previous years exports and imports, respectively; dP_x, dP_m = changes in the deflators of exports and imports respectively; GDP = gross domestic product.

The following sources for the time series data have been used:
a) real compensation of employees from National Statistical Service of Greece (NSSG), *National Accounts* ; b) number of empolyed persons from Bank of Greece, Economic Research Department, *The Bank of Greece Econometric Model of the Greek Economy*, 1992; c) employers' social security contributions and gross domestic product from NSSG, *National Accounts* ; d) exports, imports anf their deflators from Bank of Greece, *Monthly Statistical Bulletin.*

TABLE 1

Impact of labor market policies on the unemployment rate (a)

Dependent Variable: Unemployment rate **Sample 1974-1991**

	[1-1]	[1-2]	[1-3]
Constant	2.807	2.90	2.418
	(2.25)	(4.77)	(4.43)
Lagged unemployment rate	0.572	0.433	0.539
	(6.61)	(3.93)	(5.96)
Vacancy rate	-0.054	-0.063	-0.066
	(1.62)	(2.25)	(2.16)
Unemployment insurance	0.780	0.052	0.761
	(3.46)	(2.15)	(3.99)
Active policies	-0.107		
	(0.54)		
Training		-0.335	
		(1.76)	
Placement services			-0.110
			(0.94)
Adj.R^2	0.950	0.959	0.952
S.E.R.	0.112	0.102	0.109
BG (2) (b)	4.34	3.341	5.422
ARCH (2) (b)	0.571	1.245	0.806
JB (b)	1.208	0.860	0.813
Chow (S, 1984) (c)	2.773	1.632	1.845
Chow (F, 1989) (d)	2.55	1.364	1.773

Notes: (a): Estimation by OLS method. All variables entered in regressions in natural logarithms. The numbers in parentheses are (the absolute values of the) t-statistics. (b): Critical value at 5% level 5.99 [$x^2(2)$]. (c): Critical value at 5% level of F(5, 8) is 3.69. (d) Critical value at 5% level of F (3, 10) is 3.71.

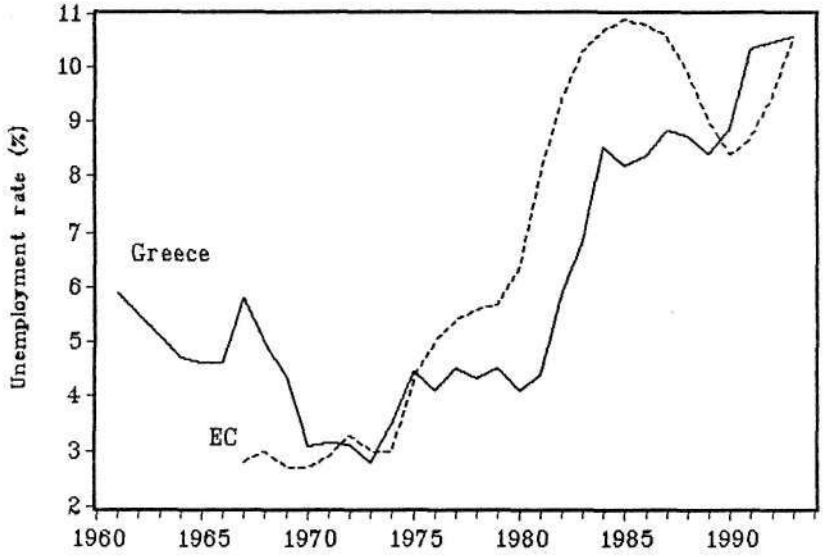

Figure 1. Unemployment in Greece and the European community

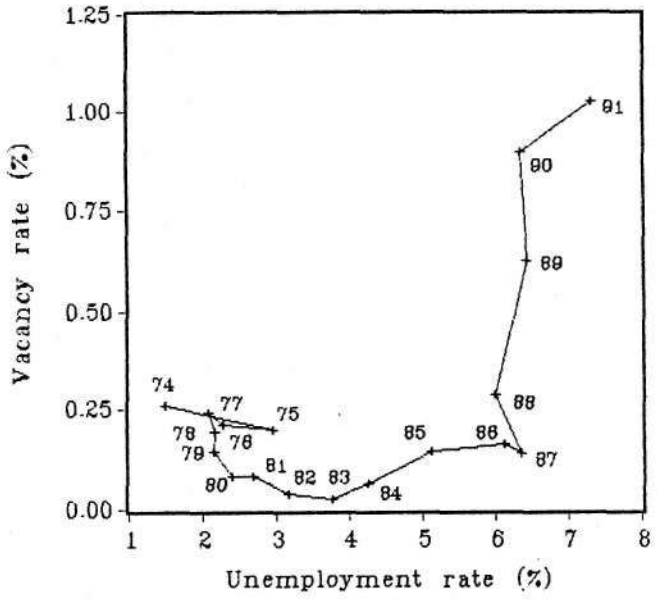

Figure 2. UV curve 1974-1991

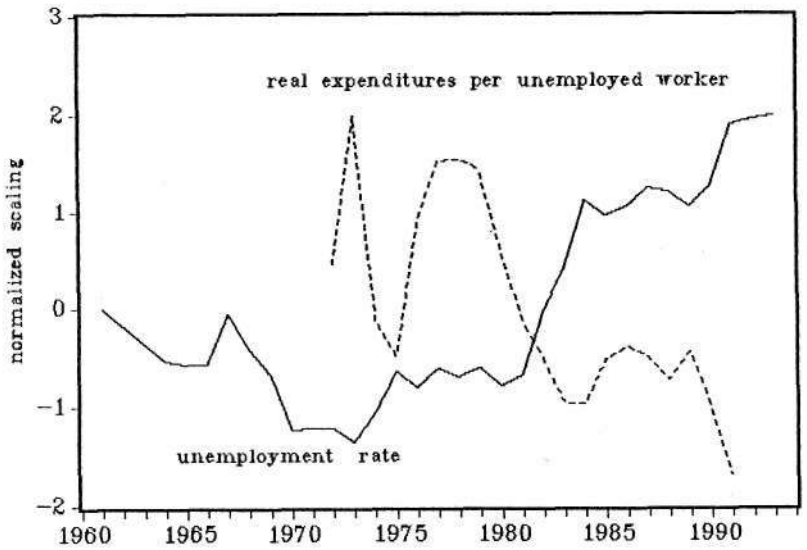

Figure 3. Active labor market policies and unemployment

Notes

1. The unemployment rates for the European Community are from OECD, *Quarterly Labour Force Statistics,* no. 1, 1986 and no. 1, 1994. The data used for Greece are from Bank of Greece, Economic Research Department, *The Bank of Greece Econometric Model of the Greek Economy.* We do not use unemployment data from the National Statistical Sevice of Greece because this time series is available from 1975 for the urban and semi-urban areas, while figures for the whole country have only been published since 1981. It should be noted, however, that both time series for Greece follow the same upswing in the unemployment rate in the 1980s.

2. For the period 1961-1974, for instance, the real hourly earnings in Greek manufacturing were, on average, 31.2% of the corresponding earnings in West Germany.

3. Unfortunately, published data of job vacancies by the Manpower Employment Organisation (MEO) are available only from 1974. Hence, we could not analyze the UV curve before that year. Provided that the job vacancy time series required is published by MEO, we are constrained to use the unemployment rate series published by this state institution to construct the UV curve (source: MEO, *Annual Statistics).* It is noticeable that MEO, the official agency for the registration of unemployment and responsible for conducting the government's labor market policies, underestimates total unemployment. Unemployment figures concern only wage and salary earners who have been employed in the past and who fulfil certain requirements. Young people seeking jobs for the first time are not included. In any case, the observed pattern of MEO unemployment rates follows the same pattern as the relevant series illustrated in Figure 1 of the text.

4. Data sources: National Statistical Service of Greece, *National Accounts,* 1979, 1988. The consumer price deflator time series is available in Bank of Greece, *Monthly Statistical Bulletin.*

5. Data are available from the Federation of Greek Industries and ICAP (a private market research company).

6. In 1991 the ten biggest industrial loss-making firms, with losses amounting to over one per cent of GDP, were all state-controlled.

7. This survey concentrates on large-scale manufacturing (firms with more than 250 employees) in Northern Greece. The basic trends observed in this survey could be regarded indicative of similar trends for the whole country, given that Northern Greek manufacturing is by far the second largest industrial pole of the country.

8. Unfortunately, the wave of lay-offs is expected to go on if one considers the mere fact that in 1991 ailing firms accounted for one-quarter of total employment in establishments with more than 10 employees.

9. For empirical evidence supporting the sorting theory of unemployment persistence see Gregory (1986).

10. Only in the pre-electoral 1988-1989 period were the restrictive macroeconomic policies considerably relaxed. It is noticeable, however, that high unemployment rates persisted even during this period.

11. Data for the expenditures of the labor market programs under consideration are available from 1974 in MEO, *Annual Statistics.* The time series of wage and salary bill is available in National Statistical Service of Greece, *National Accounts,* 1979,1988,1992. For the data sources of the registered unemployment and vacancy rates see above, note 3.

12. For an analysis of the two contrasting phases of labor productivity in postwar Greece see Mihail (1995).

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