

Why Has Unemployment in the Netherlands and the United Kingdom Fallen so Much?

STEVE NICKELL

*Centre for Economic Performance
London School of Economics*

JAN VAN OURS

*CentER for Economic Research
Department of Economics, Tilburg University
Institute for Labour Studies (OSA) and CEPR*

La Grande-Bretagne et la Hollande ont expérimenté un déclin majeur dans le taux de chômage depuis le début des années 80. Dans la même période de temps, il y a eu également un déclin dans le taux de non-emploi. Puisque dans la plupart des pays de l'Union Européenne, ces déclins ne se sont pas produits, un miracle dans le chômage doit s'être produit dans ces deux pays. Une combinaison de politiques orientées sur l'offre causant une réduction significative dans le taux d'équilibre de chômage dans ces deux pays sont responsables de ces résultats.

The Netherlands and the United Kingdom have experienced a major decline in unemployment rates since the early 1980s. Over the same period, there was also a strong decline in non-employment rates. Since in most other countries of the European Union such declines did not occur there is something of an unemployment miracle in both countries. Combinations of supply-oriented policies causing a significant reduction of equilibrium unemployment rates in both countries are responsible for this.

INTRODUCTION

Unemployment in the European Union has been persistently high ever since the beginning of the 1980s. However, not every EU country has the same unemployment experience. The Netherlands (NL) and the United Kingdom (UK) are among the countries whose job markets have performed well in recent years, particularly on the unemployment front. The main questions we address in this paper

are whether the NL and the UK really have had such an outstanding labour market performance, if so why this is the case, and whether there are lessons to be learned for other countries.

The changes in unemployment in which we are interested are both substantial and long lasting, so that we must focus on factors that influence the equilibrium rate of unemployment. This is the baseline level of unemployment such that if actual unemployment

moves too far below it, then inflation starts rising and the trade balance deteriorates. The equilibrium rate of unemployment cannot be changed with monetary, fiscal or exchange rate policy. What these policies can do is change the way in which actual unemployment fluctuates around the equilibrium rate. Nevertheless, the equilibrium rate may change from one decade to the next for other reasons. These include anything that systematically changes inflationary pressure in the economy at a given level of unemployment. So in order to explain the unemployment patterns, we need to point to a series of factors that tended to raise inflationary pressure in the 1970s and early 1980s but have since turned around. Our main interest is in identifying the main candidates for explaining the decline in equilibrium unemployment and thus the unemployment miracle. We advocate that these are: the reduced power of the unions in wage negotiations, the increased importance of financial incentives in the labour market, and the active labour market policies.

In this paper we focus on aggregate unemployment rates.¹ We present some information about differences in unemployment rates between males and females and between age groups, but we omit any further details on differences between educational categories, ethnic groups, short-term and long-term unemployed, etc. (Nickell and van Ours 1999, give more information on this). Countries may have low unemployment rates because they shift people from unemployment into other non-working categories. So, because unemployment rates may be only part of the story we also study non-employment rates. Furthermore, we highlight some typical features of the Dutch and British labour markets.

The remainder of our paper is set up as follows. In the next section we discuss the development of unemployment and non-employment in the NL and the UK in more detail. We compare the evolution of unemployment in both countries with the EU average to indicate that there is indeed a significant absolute and relative decline. In the third section we discuss sickness, disability, part-time labour, and

female labour market participation. Section four discusses potential reasons for the decline in unemployment rates in the NL and the UK. In Section five we present the main institutional changes in both countries. The final section concludes.

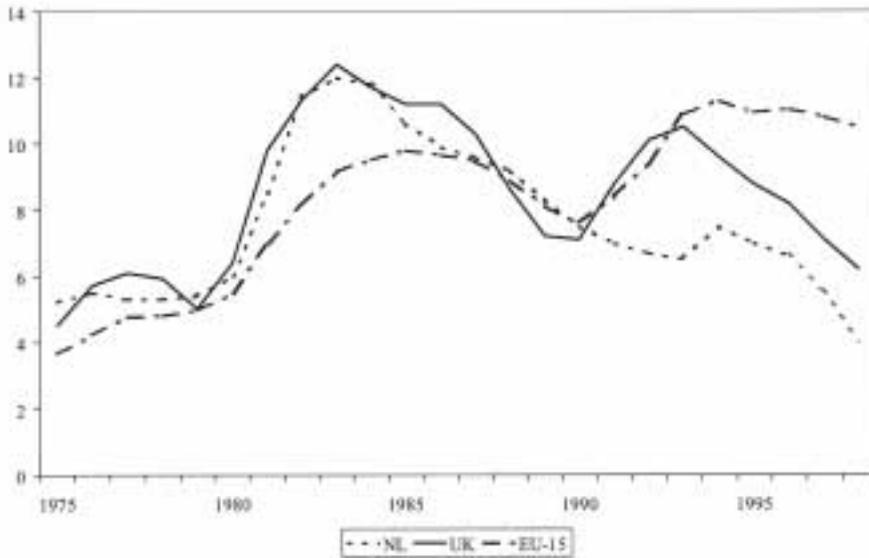
UNEMPLOYMENT AND NON-EMPLOYMENT IN THE NL AND THE UK

Unemployment

As shown in Figure 1 up to the beginning of the 1990s unemployment rates in the NL and the UK are remarkably similar. In the mid-1970s the unemployment rate in both countries was level at around 5 percent. After the second oil shock at the beginning of the 1980s, unemployment exploded. Unemployment in the NL increased at a speed of about 10,000 persons per month to reach a maximum of 12 percent in 1983. In the UK the increase was to a large extent similar. After 1983 unemployment steadily declined, a decline that was only interrupted in the NL by the recession of 1994-95 and in the UK by the severe recession of 1991-93. In 1998 the unemployment rate of 4 percent in the NL and 6 percent in the UK was down to the level of 1974, right after the first oil shock. Figure 1 also indicates that the unemployment experience in the NL and the UK is truly outstanding from a European perspective. In the first half of the 1980s unemployment in both countries was substantially higher than the EU average. In the beginning of the 1990s, the NL and the UK are back at the EU average. The NL fell below EU unemployment at the beginning of the 1990s, the UK following in 1993.

In the development of the Dutch labour market, several periods may be distinguished (see, e.g., Hartog 1999). The first major shock to the Dutch labour market was caused by the oil crisis of 1973. Unemployment started to increase. The Dutch government introduced an expansionary policy, financed by the abundant revenues from natural gas. The 1970s are the decade of the Dutch disease, characterized by inflation, expanding government

FIGURE 1
Unemployment Rates, NL, UK and EU-15, 1975-1998 (%)



expenditures and sharply declining profits. Despite several government interventions in the wage negotiations, wages increased substantially. The second oil crisis of 1979 fuelled a deterioration of the Dutch labour market and unemployment rose at an unprecedented speed. Although there is some debate on it, the year 1982 is considered by many to be a turning point. In that year, under pressure from the seemingly endless rise in unemployment, a central agreement was reached between the labour unions and the employers' federation. In this so-called Wassenaar Agreement and other agreements that were established at the same time, there were arrangements concerning wage restraint, reduction in working hours, restoration of profit levels of firms, labour market flexibility, early retirement, and the creation of jobs. At the same time, the government agreed to get its budget under control, reform social security, and reduce taxes. In the course of the 1980s many of these agreements were implemented. In 1987 there was a major restructuring of unem-

ployment benefits, sickness benefits, disability benefits, and welfare benefits. The replacement ratios were lowered from 80 to 70 percent and eligibility rules were tightened. We return to this below.

In order to understand the evolution of UK unemployment, we use the fact that when actual unemployment is well above the equilibrium rate, we can expect to observe falling inflation and/or a large surplus on the balance of payments. Conversely, when actual unemployment is well below the equilibrium rate, we can expect rising inflation and/or a large deficit on the balance of payments. We use the numbers generated by Layard, Nickell and Jackman (1991, pp. 435-48) as our reference point. The notable features of this pattern begin in the late 1960s. Earlier, both actual and equilibrium unemployment were relatively stable at around 2.5 percent. In the 1970s equilibrium unemployment started to rise as unions became stronger and workers attempted to maintain their living standards after

TABLE 1
Unemployment Rates and Non-employment Rates by Sex, Age Group and Education¹

		<i>Unemployment Rates</i>					<i>Non-Employment Rates</i>				
		<i>1979</i>	<i>1985</i>	<i>1990</i>	<i>1995</i>	<i>1998</i>	<i>1979</i>	<i>1985</i>	<i>1990</i>	<i>1995</i>	<i>1998</i>
NETHERLANDS											
<i>Total</i>		6.2	12.8	5.9	7.0	4.1	46.1	47.7	44.8	42.2	37.8
<i>Age</i>	25-54	4.7	10.8	5.6	6.8	4.1	38.1	37.2	33.9	30.2	24.9
	55-64	6.6	13.2	3.2	3.2	2.6	64.8	72.6	74.2	74.2	69.5
<i>Male</i>		4.5	11.2	5.4	6.4	3.7	24.5	31.3	28.9	28.4	24.7
<i>Age</i>	25-54	3.2	9.2	5.2	6.2	3.7	8.7	15.0	12.9	12.9	10.7
	55-64	5.9	13.1	3.1	3.1	2.2	39.9	55.2	58.4	61.2	55.6
<i>Female</i>		10.3	15.7	6.8	8.1	4.8	68.3	64.4	61.2	56.5	51.3
<i>Age</i>	25-54	8.8	14.3	6.6	7.8	4.9	68.8	60.5	55.9	48.2	42.8
	55-64	9.5	13.6	3.6	4.0	4.1	87.5	88.4	89.1	87.0	82.7
UNITED KINGDOM											
<i>Total</i>		4.4	11.2	7.1	8.8	6.2	24.5	28.9	24.1	26.8	24.4
<i>Age</i>	25-54	4.6	9.3	6.3	7.3	4.9	23.0	26.1	20.8	23.0	21.0
	55-64	4.4	8.1	7.9	8.4	5.8	30.9	42.5	41.3	46.2	43.9
<i>Male</i>		4.0	11.5	7.1	10.1	6.8	9.2	18.8	15.7	21.5	18.8
<i>Age</i>	25-54	4.0	9.5	6.3	8.4	5.3	6.1	13.5	10.4	15.3	13.6
	55-64	4.5	8.9	8.8	10.1	6.8	20.1	37.7	37.7	45.4	41.9
<i>Female</i>		5.2	10.8	6.5	6.8	5.3	41.3	40.3	33.3	32.8	30.7
<i>Age</i>	25-54	5.5	8.9	6.4	6.0	4.5	40.1	38.6	31.4	30.9	28.6
	55-59	4.2	6.1	5.6	4.7	3.5	48.5	51.5	48.2	47.8	47.8

Note: ¹The UK total for the older age group actually refers to men aged 55-64 and women aged 55-59, 60 being the official age of retirement for women. The non-employment figures for the NL are based on official Dutch statistics and differ from the OECD numbers in Table 2 because the Dutch definition of employment refers to jobs of at least 12 hours of work per week and the OECD/ILO definition refers to jobs of at least one hour per week. In the NL the definition of unemployment changed in 1987. The figures before and after this change are not fully comparable. The 1998-figures for the NL age groups are preliminary.

Source: For NL, Dutch Central Bureau of Statistics; for UK, Spring Labour Force Survey.

the first oil shock. Until 1980 unemployment was sustained below the equilibrium rate at the cost of rising inflation and a balance of payments deficit in the latter part of the period. Then in the first half of the 1980s, after the second oil shock, unemployment rose above the equilibrium rate with falling inflation and a large payments surplus. As unemployment fell relative to a stable equilibrium rate in the late 1980s, inflation began to rise and the balance of payments went into deficit again, with this situation reversing in the early 1990s. More recently, the equilibrium rate appears to have fallen and currently, actual unemployment is probably somewhat below it, although it is unlikely to remain so for very long.

As indicated in the introduction we do not go into a lot of details concerning the structure of unemployment, but highlight male-female and age differences. Table 1 shows that in the NL unemployment rates for males are lower than they are for females. In 1998 the unemployment rate of males was 3.7 percent, the female unemployment rate was 4.8 percent. The differences in unemployment rates have become smaller over time. In 1979 the unemployment rate of males was 4.5 percent, while it was 10.3 percent for females. There are differences between the age groups as well. Until the 1990s the unemployment rates of older workers were higher than those of workers aged 25-54 years. In the 1990s the opposite was the case. This has to do with the changes in eligibility criteria. Unemployed workers older than 57 and a half years have no obligation to search for a job and are therefore not counted as unemployed.

For the UK, in the slump of the early 1980s, unemployment rates among men and women were much the same. In the 1970s, they tended to be somewhat higher for women. However, since that time, the unemployment rate for women has fallen substantially relative to that for men, so that it is the female labour market that has made a major contribution to the overall decline in the UK unemployment rate. This was particularly noticeable during the slump of the early 1990s when male un-

employment peaked at 12.5 percent in the spring of 1993 whereas female unemployment reached only 8 percent at the same time

Non-employment

Countries may have low unemployment rates because they shift people from unemployment into other non-working categories. So, because unemployment rates may be only part of the story we also study non-employment rates. While both the NL and the UK have enjoyed some success in reducing unemployment since the early 1980s, their relative performance in getting the population of working age into jobs turns out to be less impressive. It is true that the number of non-employed individuals of prime age in the NL has fallen sharply over the last 20 years but this only represents a convergence to the North-European standard of somewhere between 15 and 25 percent. Meanwhile, non-employment rates among older workers in the NL remain among the highest in the Organization for Economic Cooperation and Development (OECD). In Britain, there has not been any great change in non-employment rates, except for a small fall among the prime-age group because of the fall in unemployment since 1983.

The average non-employment rate in the NL has gone down substantially since 1985 from 48 percent to 38 percent in 1998. There is a very different pattern for men and women. Over the period 1985-98 the non-employment rate for males went down by seven percentage points, for females the decline was 13 percentage points.² The non-employment rate increases with age. In 1990 the male age group 25-34 years had a non-employment rate of 12 percent, while the age group 45-54 years had a non-employment rate of 18 percent. The 55+ group has by far the highest non-employment rate of all male age groups; in 1990 this group of males had an average non-employment rate of 58 percent. The high non-employment rate among the oldest workers has to do with disability mainly.³ We return to this phenomenon in more detail below. The non-employment rate among females is substantially

higher and increases rapidly with age. In 1990, the non-employment rate among the female age group 25-34 years was 47 percent, while among the age group 45-54 years it was 67 percent. The non-employment rate among the age group 55-64 was even 89 percent. The increasing non-employment rate over the age categories has to do with the labour market participation of females, which declines rapidly with age. Over the 1990s there has been a remarkable decline in the non-employment rates for all age groups except for the oldest male workers.

The non-employment rate among prime-age people in the UK has remained pretty stable since the late 1970s. But this hides very different patterns for men and women as we see in Table 1. Over this period, the non-employment rate among prime-age men has risen from 6.1 to 13.6 percent. By contrast, the rate among prime-age women has fallen from 40 to 28.6 percent. Since the total changes in unemployment have been rather small over this period, much of these changes are due to the rise in inactivity among prime-age men and the rise in labour market participation among prime-age women. The role of disability in the former is an issue we shall pursue. By contrast, for older people, the rise in non-employment among men since 1979 has not been offset by a significant fall in non-employment among women which remains stubbornly around 50 percent.

TYPICAL FEATURES OF THE DUTCH AND BRITISH LABOUR MARKETS

Sickness and Disability

Table 2 shows the incidence of disability benefits in the NL and the sickness inactivity rate in the UK distinguished by age and gender. The disability rates among Dutch males are substantially higher than among females. In 1998 the male disability rate was 10.1 percent, female disability rate was 6.7 percent. The difference between males and females is age related. It appears that in the 1990s up to the age of

35 years there are hardly any differences between males and females. In 1998 of the males of age 25-35, 3 percent collected disability benefits, while this was 3.5 percent for females. For older age groups the incidence of disability benefits is substantially higher for males than for females. Of the males in age group 55-65 about one in three collects disability benefits, while for females in this age group this is 13-14 percent. In the course of the 1990s disability rates have declined for most of the male age groups, while for females there has hardly been a change.

For the UK, Table 2 presents the percentage of the relevant population who report themselves to be inactive because of sickness and ill-health (which includes disability). Among the prime-aged the numbers have risen by between three and four times since 1979, so that by 1998 there are almost as many non-workers who are inactive because of sickness and disability as there are unemployed (i.e., seeking work). Furthermore, the numbers appear to increase independently of the state of the labour market, having risen by one and a half percentage points since 1993, despite the large fall in unemployment.⁴ A similar picture appears among older workers. Back in 1979 only a tiny minority of the population aged 55-65 suffered from sickness and disability. By 1998, this group had risen to one-fifth. These changes become even more drastic once we divide the population by educational attainment. Those without any qualifications, who currently make up around one-quarter of the population of working age, have seen the most enormous increases in sickness and disability. Among prime-age UK men, a mere 3 percent of the relevant population was inactive because of sickness and disability in 1979. By 1998, this had risen to 18 percent. So nearly one-fifth of all prime-age men in the UK population without educational qualifications are currently unable to work because they are invalids! And the same applies to just over one in seven women in the same category. Furthermore, these numbers have doubled since 1992 while there has been an economic boom.

TABLE 2
 Disability Benefits (NL) and Sickness Inactivity Rates (UK)
 (Total and by Age Group; Males and Females, % of relevant population)¹

	NL					UK				
	1980	1985	1990	1995	1998	1979	1985	1990	1995	1998
<i>Total</i>	6.9	7.6	8.5	8.1	8.5	2.6	3.9	4.6	7.4	7.9
<i>Total Males</i>	10.2	10.9	11.3	10.3	10.1	3.1	4.5	5.2	8.2	8.4
25-54	8.8	9.4	9.8	8.3	8.0	1.7	2.2	2.8	4.6	5.7
55-65	34.7	36.9	36.0	33.1	32.0	8.0	12.8	15.4	21.9	20.0
<i>Total Females</i>	3.6	4.3	5.6	5.8	6.7	2.0	3.3	4.0	6.5	7.2
25-54	3.5	4.1	5.5	5.5	6.4	1.5	2.5	3.2	5.4	5.9
55-65	8.9	10.8	12.8	13.7	14.9	4.5	8.5	9.8	16.2	18.1

Note: ¹ NL: number of disability benefits. UK: rates are a percentage of the relevant working age population who report that they are inactive because of “sickness” which includes any form of ill-health or disability. The figures for 1979-83 are based on question “reason not looking for work” for the inactive. 1985-91 are based on questions “reason not looking for work in last week” and “reason not looking for work at all” for the inactive. 1992-98 are based on questions “reason not looking for work in last 4 weeks” and “reason not want work in last 4 weeks” for the inactive.

Source: UK Labour Force Survey, Spring Quarter. For NL, National Institute for Social Insurance.

The use of disability benefits in the NL is remarkably high. The story of the increasing disability starts in 1967 when the comprehensive disability insurance for employees (WAO) was introduced. Under the terms of this law workers were insured against wage loss due to long-term disability. From then on if a worker became ill, he or she was allowed to claim a benefit under the illness scheme for a maximum period of one year. After that the worker could claim a disability benefit. Workers were entitled to disability benefits after a so-called disability examination, which consisted of a medical examination as well as an investigation of the labour market position of the worker. A worker could be considered disabled if there was no suitable job at the educational level in the previous occupation. Furthermore,

unemployment was “internalized,” which means that those workers who were considered to be partially (more than 15 percent) disabled, could collect full disability benefits because it was assumed that partially disabled were doomed to remain unemployed. The benefit had a maximum of 80 percent of the wage in the last job. Disability benefits could be collected until age 65. Since the introduction of comprehensive disability insurance the number of workers collecting disability benefits has increased massively. This huge increase in the numbers on disability benefits induced the government to adjust some elements of the disability benefit system on several occasions. In 1981 the rules to calculate the wage in the last job changed: tips and overtime were no longer included in the calculations. In 1985-

87 the maximum percentage of 80 percent of the previous wage was reduced to 70 percent. In 1987 there was a major restructuring of the disability benefit system of which the main objective was to reduce the inflow into disability. The most important change was the abolition of the “internalization of unemployment” rules. Partially disabled workers were considered as such and were expected to find a job or claim unemployment benefits for their remaining work capacity. The reform of the disability insurance was very important. Empirical studies find that before the 1987 reform of the disability benefit system, up to 50 percent of the disability enrolment was related to redundancy of workers. Hassink, van Ours and Ridder (1997) show that at the end of the 1980s employers in the NL still used disability enrolment as an alternative to dismissals. They find that about 10 percent of the transitions into disability are due to redundancy of the worker. An implication of this result is that even after the social security reform of 1987, some employers and employees, in order to avoid dismissal, used disability enrolment. However, comparing this type of behaviour is much less common than before the reform. In the early 1990s there were some further changes, for example, the disability insurance premium was experience-rated, the disability examination no longer took the availability of suitable jobs with respect to education and previous occupation into consideration, the duration of the benefit was limited to five years after which a re-examination had to take place, and all disabled workers younger than 50 years had to be re-examined. Since 1993 the number of workers collecting disability benefits slowly declined. In the period 1994-96 the outflow into disability was larger than the inflow into disability. The inflow into disability started declining in the beginning of the 1990s, a decline that coincides with the change in eligibility criteria. Over the same period the outflow increased slowly. In 1997 the old situation was restored and the inflow is again larger than the outflow. Thus, it seems that the change in the system of disability benefits only had a temporary effect and did not solve the structural problem of the extreme high numbers of workers with disability benefits.

What happened in the UK? First, there are some incentives in the direction of disability. Benefits tend to be higher and more secure, since there is little pressure to take up work. Furthermore, for those who worked in the Employment Service, there were incentives to shift unemployed individuals onto disability schemes, particularly if they were hard to place in work. Second, it is clear from the report on disability by the UK National Audit Office (1989) that a variety of non-medical factors are taken into account by doctors involved in disability assessment. These include whether or not a claimant had been advised by the Employment Service to seek a statement of disability. However, it is only fair to add that the reasons underlying the dramatic rise in the sickness and disability numbers are not well understood. Indeed they are causing considerable anxiety to the UK Department of Social Security which is intent on reforming the system.

Part-Time Labour and Female Participation

Table 3 shows the incidence of part-time labour in both the NL and the UK. The incidence of part-time labour among females is substantially higher in the NL than in the UK. In 1996, 68 percent of all Dutch employed females worked part-time, while in the UK 45 percent of all employed females worked part-time. In the NL the share of part-time labour is also increasing faster than in the UK. In both countries the incidence of part-time labour is substantially

TABLE 3
Part-Time Labour (% of total)

	<i>Males</i>			<i>Females</i>		
	<i>1983</i>	<i>1990</i>	<i>1996</i>	<i>1983</i>	<i>1990</i>	<i>1996</i>
NL	7	15	17	50	59	68
UK	3	5	8	42	43	45
EU-15	3	4	5	26	28	32

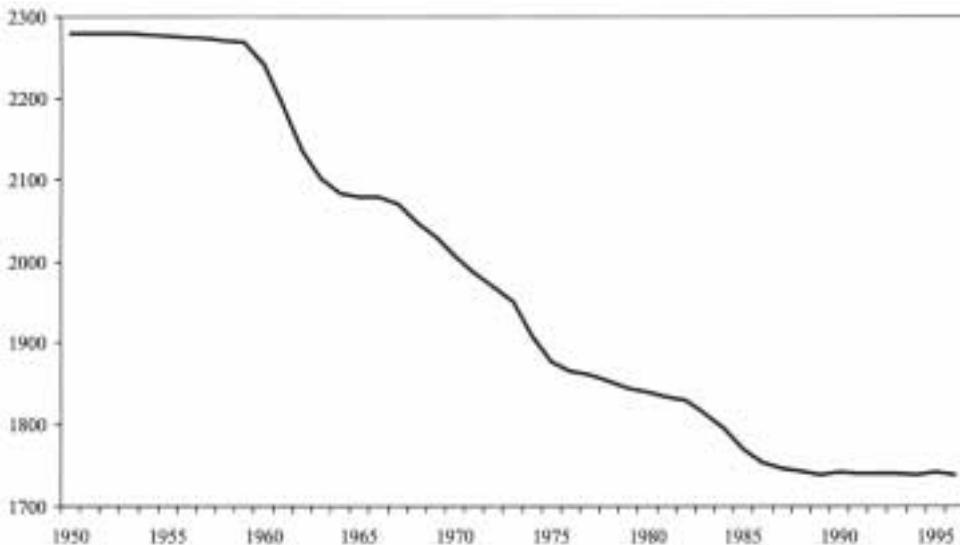
Source: Ministry of Social Affairs and Employment (1998).

higher than the EU average, which was 32 percent in 1996. This increase in part-time labour is intimately connected to the rise in female participation. The participation rate of Dutch males was 80 percent in 1980, 79 percent in 1990 and again 80 percent in 1996. So, if anything there has hardly been a change in labour market participation over the past decades. For Dutch females this situation is completely different. The participation rate of Dutch females was 36 percent in 1980, 45 percent in 1990 and 53 percent in 1996. So, for females there has been a major increase in labour market participation. Furthermore, to a large extent part-time labour accords with the preferences of the workers. For example 78 percent of working part-time women in the NL do not want a full-time job (OECD 1994, Table 6.14). The huge increase of part-time labour in the NL is a combination of several developments. For a long time labour market participation of Dutch females has been rather low compared to other European countries. The increase in female participation is partly a catch-up effect. Furthermore,

barriers for part-time employment have been removed. In the Wassenaar Agreement the unions agreed to reduced working hours and they gave up their resistance to part-time jobs. Figure 2 shows that the decline in working hours has been going on for quite some time. A full-time worker on average worked about 2,250 hours in 1960. By 1990 this number had fallen to 1,740. This decline is due to an increase in the length of the holidays and the introduction of so-called “shorter working hours” days, which are non-working days that the worker can choose to have throughout the year.

After the unions gave up their resistance to part-time jobs there has been a positive interaction between supply and demand. For employers part-time jobs are useful because they give flexibility to allocate more labour toward weekly peak hours in production (e.g., in retailing) and because it attracts new labour supply. Females who withdrew from the labour market for family reasons return to take up part-time jobs and females who would otherwise

FIGURE 2
NL Hours per Year of Full-Time Workers, 1950-1996 (hours/year)

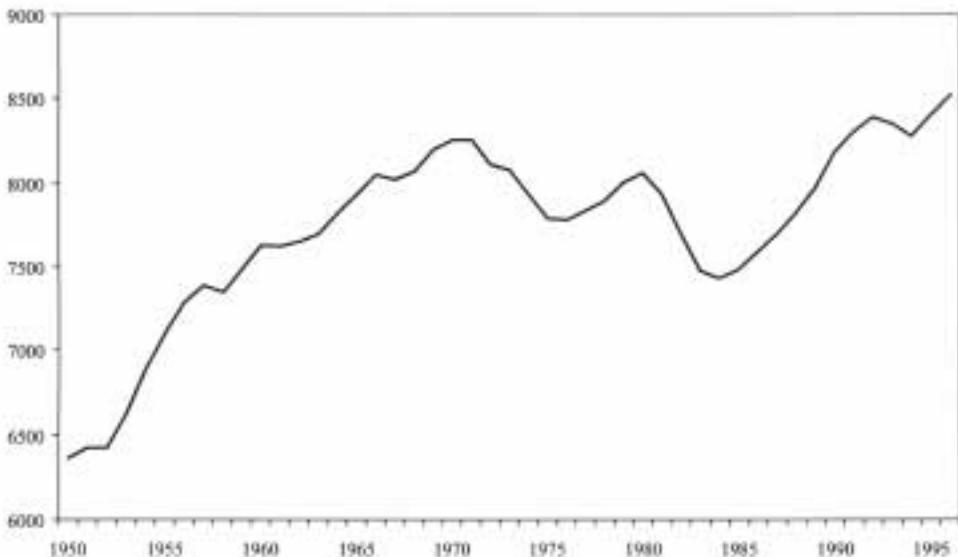


have left the labour market are now staying in part-time jobs. So, the effective labour supply has increased. For females, part-time jobs are valuable because they allow them to combine paid work with child care. It is our impression that the increase in part-time jobs has had a positive effect on employment growth: the mere fact that an effective labour-supply increase allowed many firms to expand their business. Part-time labour is not just a redistribution of a fixed amount of labour over a larger number of workers (the “lump of labour fallacy”). As indicated in Figure 3 in the period of rapid growth of part-time work the total number of hours worked in the NL has increased from 7.4 billion in 1985 to 8.6 billion in 1996. The total number of working hours in 1960 was 7.6 billion and reaches a first maximum in 1970 with 8.3 billion working hours. After that, employment in terms of working hours declined to reach a minimum of 7.4 billion in 1985. Since many of the part-time jobs are taken by workers who come from outside the labour market it is more the non-employment rate than the unem-

ployment rate that went down because of the increase in part-time labour. Nevertheless, we advocate that even the unemployment rate went down because of the reduction in the barriers to part-time work.

The decline in non-employment among UK women recorded in Table 1 is mainly due to the rise in labour market participation rates among prime-age women which has been going on in Britain since 1950. Starting out at well below 50 percent in 1951, the participation rate among women aged 25 to 54 had reached 66.7 percent in 1983 and 75 percent by 1997. This, incidentally, contrasts with the prime-age male rate, which fell from 95.2 percent in 1983 to 91.6 percent in 1997. This rise in women’s participation is common to more or less all OECD countries, although it has gone a lot further in northern than in southern Europe. There is a significant element of part-time work for women in the UK although the proportion has remained relatively stable since the late 1970s with around 40 percent working less than 30 hours per week. It is important

FIGURE 3
NL Employment, 1950-1996 (millions of hours)



to recognize that most part-time workers would not prefer a full-time job (78 percent in the NL, 94 percent in the UK; OECD 1994, Table 6.14), and that the elimination of barriers to part-time work has raised welfare significantly.

WHY HAS UNEMPLOYMENT FALLEN?

The Equilibrium Rate of Unemployment

Why are the NL and the UK doing better now on the unemployment front than they were in the early 1980s? This is our main concern, but it is associated with another question, namely why did unemployment rise so much from the late 1960s to the early 1980s in both countries? In order to confront these questions, it is worth noting at the outset that the changes in unemployment in which we are interested are both substantial and long-lasting, so that we must focus on factors that influence the equilibrium rate of unemployment. As we noted in the introduction, this is the baseline level of unemployment such that if actual unemployment moves too far below it, then inflation starts rising and the trade balance deteriorates. The equilibrium rate may change from one decade to the next as a consequence of any

factor that systematically changes inflationary pressure in the economy at a given level of unemployment. So in order to explain the unemployment patterns, we need to point to a series of factors whose impact tended to raise inflationary pressure in the 1970s and early 1980s, but have since turned around.

The Determinants of the Equilibrium Unemployment Rate

As we have already noted, the equilibrium unemployment rate is the rate associated with stable inflation. So any labour market factor that tends systematically to raise inflationary pressure in the labour market *at a given level of unemployment* will tend to increase the equilibrium unemployment rate. In theory, relevant factors are: benefits and active labour market policies, unions and wage setting, minimum wages, labour taxes and commodity prices, skill mismatch, and employment protection. Empirical studies indicate that not all of these factors are equally relevant (a lot of references are given in Nickell 1997; and Nickell and Layard 1998; see Nickell and van Ours 1999 for further details). In Table 4 we give a summary overview of potential determinants along with their impact on unemployment.

TABLE 4
Evidence on the Impact of Supply-Side Factors on Unemployment

<i>Supply-Side Factors</i>	<i>Impact on Unemployment</i>	
	<i>Short-Run</i>	<i>Long-Run</i>
Benefits	++	++
Active labour market policies	—?	—?
Unions (uncoordinated bargaining)	++	++
Unions (coordinated bargaining)	0	0
Minimum wages	+?	+?
Labour taxes	++	+?
Commodity prices	++	+?
Skill mismatch	+	+
Employment protection	+?	+?

Source: Nickell (1997); Nickell and Layard (1998); Nickell and van Ours (1999).

The impact of a high benefit replacement ratio on unemployment is well documented both in terms of its effect in lengthening the unemployment durations of individuals and its impact on unemployment in cross-country studies using both time series and cross-section information. A second feature of the benefit system that is important is the duration of entitlement. Again the evidence points conclusively to the fact that long-term benefits help create long-term unemployment. An important question is whether or not the effects of a relatively generous benefit system can be offset by active labour market policies whose ostensible purpose is to make unemployed individuals more willing and able to return to work. The evidence here is as mixed as the policies. Basically, some types of programs work well and others do not. However, combining a generous benefit system with well-designed, active labour market programs and strictly applied search criteria and work tests for benefit eligibility will lead to lower unemployment levels than a system that provides benefits with few strings attached.

With respect to unions there is a mass of evidence that they force firms to pay higher wages than would be paid to similar workers in non-union firms. Cross-country comparisons indicate that because unions increase wage pressure, they will, *ceteris paribus*, raise equilibrium unemployment. Furthermore, the more workers who are covered by union collective agreements, the bigger the effect. There are three factors that can mitigate the unfavourable impact of unionized collective bargaining on equilibrium unemployment. First, the government can enact legislation that directly weakens the power of unions in wage bargaining by, for example, restricting the right to strike. Second, unions are less able to raise wages in those firms that are subject to a high degree of national and international product market competition. Third, equilibrium unemployment will be lower if there is some institutional mechanism by which the parties wage bargains to take into account the macroeconomic, and particularly, the employment implications of the bargains they jointly strike. We refer to this as coordination, which may

be achieved by government action at the central level or by the joint actions of groups of firms and unions. Evidence suggests that coordination can fully offset the negative effects of widespread unionized collective wage bargaining

Regarding minimum wages there is very little consensus. Minimum wages are typically set low enough not to have a significant impact on adult male unemployment. However, in countries where the minimum is not seriously adjusted for young people (e.g., France and Spain) or which have very high payroll taxes (e.g., France and Italy), there is some evidence that youth unemployment rates are increased.

Considering taxes, there are two important questions. First, is unemployment affected by a shift of the tax burden from one element of the labour tax wedge to another (for example, a shift from payroll taxes to consumption taxes)? Second, is unemployment influenced by the labour tax burden overall? To answer the first question we need to know whether different taxes exhibit differential rates of shifting onto labour. The time series results show no clear pattern. However, in the multi-country investigations there is no significant evidence that payroll, income or consumption taxes have a differential impact on labour costs and hence on unemployment. With regard to the second question, the evidence on the impact of the overall labour tax rate on unemployment is not clear-cut. There is a suggestion that changes in the tax wedge have no long-run effects on labour costs although they do have substantial and long-lasting, short-run effects. By contrast some large long-run effects of the tax wedge on labour costs and hence on unemployment are reported for some countries. Unfortunately, as the summary table in Nickell and Layard (1998, Table 18) indicates, there is little in the way of a consistent pattern about these results. With regard to commodity prices, a similar picture emerges. There is a considerable body of evidence that commodity prices in general, and the oil price in particular, have an impact on equilibrium

unemployment, although whether it is permanent or temporary is less clear-cut.

There is a lot of general evidence that mismatch between unemployed job-seekers and available vacancies tends to raise unemployment. However, in the present context, we are particularly interested in skill mismatch, in part because in the UK there has been a substantial fall in the relative wages of the unskilled since 1980 and in part because of the relative worsening of the labour market position of the unskilled more widely. The cross-country evidence indicates that basically, only the US and the UK have exhibited significant *increases* in the excess demand for skilled labour and excess supply of unskilled labour over the last two decades. In the remaining OECD countries for which evidence is available, including the Netherlands, there is no serious evidence of the demand for skilled workers outstripping the supply (or of the supply of unskilled workers outstripping the demand) in recent years. This is, of course, consistent with the fact that only in the US and the UK has there been a dramatic increase in the dispersion of earnings over the same period. Turning to the impact on unemployment, there is some evidence that these changes have influenced unemployment in the UK contributing around 20 percent of the total equilibrium unemployment change from the late 1960s to the 1980s. The problem in Britain is that the workforce has too many low-skill workers. For example, according to the OECD literacy survey, which uses a common test, only around 10 percent of the population of working age is at the lowest level of literacy in the NL compared with more than 22 percent in the UK (see OECD 1997). This reveals the importance of providing good, basic education for the whole population rather than allowing the lower part of the ability range to miss out, as in the UK.

Finally, employment protection laws will tend to reduce the separation rate from employment into unemployment and also lower the exit rate from unemployment into work as firms become more cautious about hiring. This tends to reduce short-term

unemployment and raise long-term unemployment, exactly the pattern we see in practise. As for the overall impact of these offsetting effects, the evidence indicates that the impact is minor.

When we come to look more closely at what has happened in the Netherlands and the UK, it is clear from Table 4 that we should focus particularly on changes in the benefit systems of the two countries and their wage-bargaining structures. Some of the other factors are perhaps less important, although the evidence on skill imbalances in Britain should be pursued as well as recent changes in labour taxes. Two factors we shall ignore. Minimum wages barely existed in Britain over the relevant period and there is no evidence that the minimum wage system in the NL has made any contribution to the significant labour market changes. Employment protection has weakened in both the NL and the UK in the 1980s but on the basis of the evidence, we do not feel that this has had any significant impact on unemployment patterns over the last two decades.

The Determinants of the Non-employment Rate

The non-employed of working age consist of a wide variety of different groups who are not working for various different reasons. The main groups are the unemployed, the sick and disabled, full-time students, the early retired, and those looking after families. We do not concern ourselves here with the under 25s, because so many of them are in full-time education, so aside from the unemployed, the significant groups are the sick, disabled, and early retired among men and the non-participating married women who are looking after their families.

Considering the latter first, the participation and employment rates among married women have been rising steadily in more or less all OECD countries since 1950, this rise being driven, at least in part, by increasing job opportunities and rising real wages, both supported by anti-discrimination legislation of various kinds. Mincer (1985) gives a good overview of the basic forces at work although there

are strong cross-country differences in the speed with which married women have entered the labour force which are due, in the main, to idiosyncratic social and cultural as well as economic factors.

Perhaps more interesting from our point of view are the forces governing the extent of sickness, disability, and early retirement among men. Our interest is stimulated by the steady rise in these categories in both the Netherlands and the UK, which we have discussed at some length in previous sections. Here, suffice to say that the main factors determining the numbers in these groups are the rules governing entry and the benefits available. And, as we have seen earlier, the rules governing disability are far from being exclusively medical. For example, between 1972 and 1987 in the Netherlands, a person who was partially disabled could be classified as totally disabled if it was considered that they were unable to find suitable work in the local labour market (see Blondal and Scarpetta 1998, p. 5, Table IV). These features of the system are important in any study whose concern is unemployment, because it is clear that numbers of individuals who would normally be categorized as unemployed are effectively shifted into these other categories where they are formally out of the labour force. This is typically a result of misguided attempts to reduce unemployment by lowering the supply of labour.

MAIN INSTITUTIONAL CHANGES IN THE NL AND THE UK

As we noted before, the key features of the labour market which we expect to influence the equilibrium unemployment rate are the set of financial incentives implicit in the social security system, the possible offsets due to active labour market policy, and the wage-bargaining system. These have been the subjects of substantial changes in both the NL and the UK since the early 1980s, so we consider them in turn, starting with the systems of wage determination.

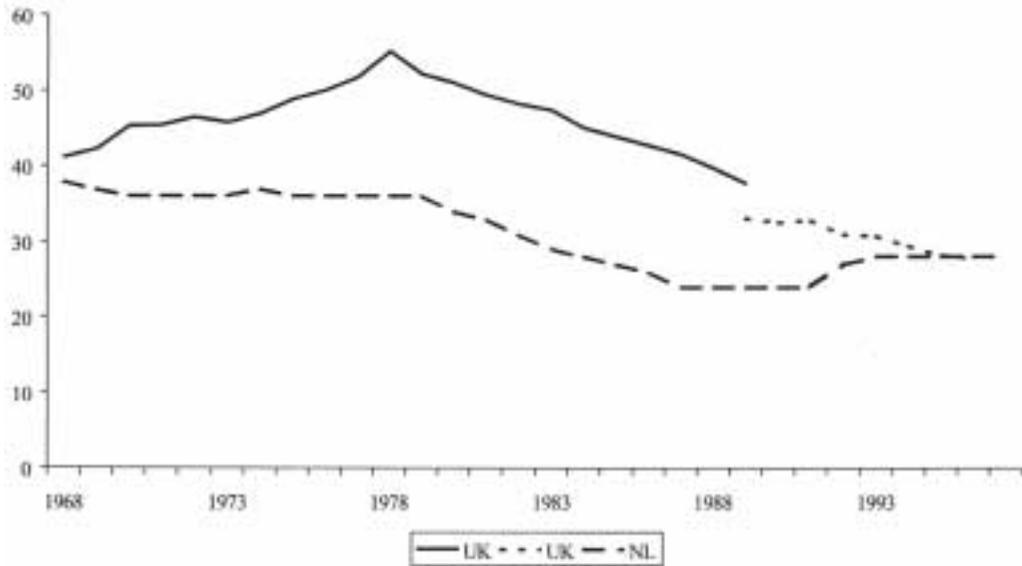
Unions and Wage Bargaining

The developments in union density in the NL and the UK are shown in Figure 4. In the 1970s in the UK union density increased, while in the NL it remained stable. In the 1980s union density goes down in both countries. In the 1990s there is some recovery of union density in the NL, while the decline continues for the UK. This means that union density at the end of the 1990s is approximately the same in both countries. However, there is a major difference in the coverage of union wage agreements. In the NL, union coverage has remained remarkably stable, going from 76 percent in 1980 to 81 percent in 1994. By contrast, in the UK it has collapsed from 70 percent in 1980 to 47 percent in 1994 and would be much lower in the private sector (see OECD 1994, ch. 5; OECD 1997, ch. 3). This extent of decline in coverage in the UK is almost unique in the OECD.

The most common opinion about the improvement of labour market performance in the NL is that it has to do with the cooperative nature of the unions. As Hartog (1999) puts it: "If there is anything like a Dutch model, it is the Dutch brand of corporatism, with consultation, co-ordination and bargaining over all important issues of socio-economic policy between union federations, employer federations and the government. The Dutch example shows that corporatist institutions are not synonymous with suffocating rigidity."

The Dutch economy was in bad shape in the early 1980s. While unemployment rates were usually below the European average, in 1982-83 unemployment was well above. As the OECD (1998) puts it: "Confronted with a deeper crisis than most other European countries, the NL started its reform process earlier, with a greater scope for improvement." Economic growth in the remaining years of the 1980s was similar to the European average. The economic downturn in 1993 was mild in the NL and the recovery much stronger than in the rest of Europe. This is probably also why unions were modest and passive. There was wage moderation. This too

FIGURE 4
NL and UK Union Density, 1968-1997 (%)



may have been related to the restructuring of the benefit system. This wage moderation may also have been responsible for the boost in part-time employment.

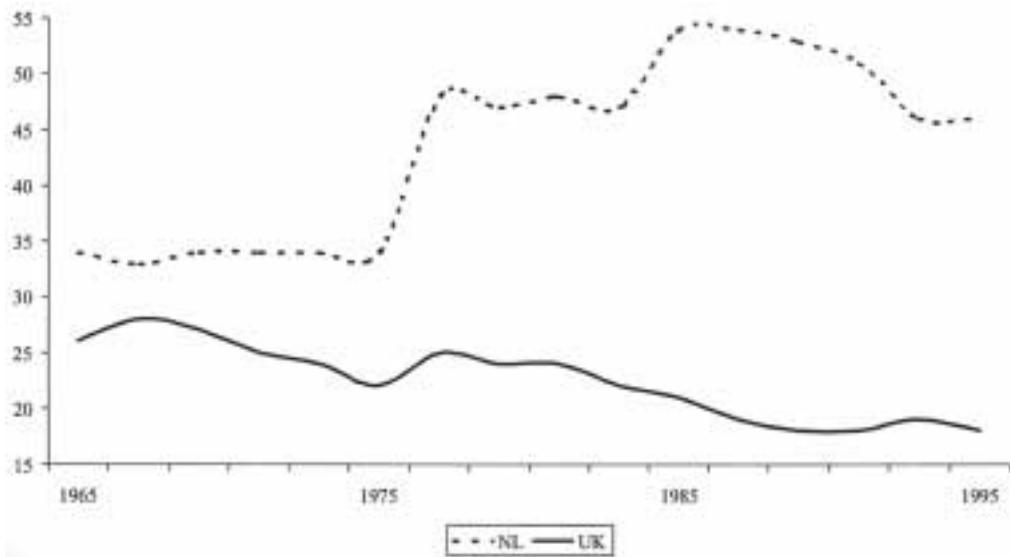
One of the most interesting contrasts between the NL and the UK concerns the role of trade unions. In the UK from the mid-1960s into the early 1970s there was a rise in trade union pressure on wages. This latter appears to have been part of an international shift which saw the number of industrial conflicts per employee in the OECD almost double in the period from 1967-74. (Incidentally, this number has declined continuously since 1974 to less than half its 1967 level!) In the NL, after the early 1980s, unions understood the need for restraining inflationary pressure in the labour market and, because of the structure of the wage bargaining system, coordinated action was introduced to bring this about. By contrast, in the UK, with a completely decentralized union bargaining system, such coor-

ordinated action was more or less impossible even had union leaders been in favour of it (which they were not). However, the combination of tough new legislation reducing union-bargaining power introduced in a series of measures in the 1980s and the decline in union representation in the private sector has, eventually, generated a significant reduction in inflationary pressure in the labour market, although this outcome has probably taken longer to achieve than in the NL.

Financial Incentives

Figure 5 shows that the average unemployment benefit replacement ratio in the NL increased substantially in the 1970s and the early 1980s. Social security in the NL changed in 1987 when a new benefit system was introduced, which also affected unemployment benefits. As Figure 5 shows since then the replacement ratio has declined. One of the other important elements of the new system was the benefit sanction. If workers do not behave according

FIGURE 5
 NL and UK Average Unemployment Benefit Replacement Rates, 1965-1995 (%)



to administrative rules a reduction of their benefit may be imposed. The main purpose is to increase the incentive to search and accept available jobs. The same type of benefit sanctions exists for welfare benefits. From research (Abbring, van den Berg and van Ours 1997; and van den Berg, van der Klaauw and van Ours 1998) it appears that benefit sanctions have a positive effect on the transition rate from unemployment to a job.

In August 1996 a new law on benefit sanctions was introduced. Under this law people who receive benefits may get a reduction of their benefits if they do not follow the rules related to the benefits (not giving proper information, lack of effort in keeping a job, refusing job offers, etc.). Sometimes people have to pay back all (or part of) their benefits if they received them for the wrong reasons. Occasionally, people have to pay a penalty.

The restructuring of the benefit system may be one of the main policy measures responsible for the

“Dutch miracle.” To give an impression of the strictness of the rules, the new rules state that an unemployed person can look for a “suitable” job for just six months. A suitable job is defined as a job according to the previous occupation, education, and earnings. After six months, highly educated unemployed have to accept a job one level below their educational level. After one year that is extended to two educational levels. After 18 months of unemployment any job offer should be considered “suitable.” For lower educated workers, after six months any job offer is suitable. Generally, the longer the duration of unemployment the more workers have to adjust their preferences in terms of temporary work, less pay, longer commuting, or even moving.

On the benefit front in the UK, things are not quite so clear-cut. While it is true that the benefit system has become tougher, with replacement rates falling since the late 1970s (see Figure 5) and stiffer work testing, the housing benefit system, which pays rent

and property taxes, has not moved in the same direction. Housing benefits, which are not included in the numbers in Figure 5, represent a substantial part of the income of the unemployed, particularly for single persons in high-rent areas and are withdrawn at a rapid rate (65p for every £1 of net income) when they become employed. This represents a substantial work disincentive. Furthermore, for most people, unemployment-related benefits remain available indefinitely. This tends to encourage long-term unemployment and the consequent persistence of high unemployment after adverse shocks as the long-term unemployed find it very hard to get back into work. The welfare-to-work (New Deal) policies being introduced by the current Labour government are designed to counteract this problem.

Active Labour Market Policy

Table 5 gives an indication of the importance of labour market programs in the NL and the UK. As shown in terms of active policy and passive policy, the NL spends a substantially larger share than does the UK. The main difference both in terms of public expenditures as in terms of participant inflows has to do with

subsidized employment. Since 1996 this active labour market policy measure has increased substantially in the NL,⁵ although since the onset of the New Deal programs in the UK in 1998, this is now currently rising fast in the UK as well. However, in the UK, active labour market policies have not had a significant role to play in the labour market improvements up to 1998.

In the NL, the number of subsidized jobs (WIW) has increased with about 40,000 in the 1990s up to 85,000 in 1998. The WIW jobs are intended for unemployed workers who are younger than 23 years and for long-term unemployed workers who collect benefits. Unemployed workers are hired by the local government, which may act as an intermediary for a job at a commercial firm. In theory, the subsidized jobs last for a maximum of two years during which the unemployed get work experience. After a period on a subsidized job the unemployed are expected to find a regular job more quickly than they would have without it.

Apart from the WIW jobs where the workers are hired by the local government there is an extensive

TABLE 5
Labour Market Programs, Public Expenditures and Participant Inflows (NL and UK averages 1994-1997)

	<i>Public Expenditures</i> (percent of GDP)		<i>Participant Inflows</i> (percent of labour force)	
	<i>NL</i>	<i>UK</i>	<i>NL</i>	<i>UK</i>
Public employment services	0.37	0.21	-	-
Labour market training	0.16	0.12	0.9	1.2
Youth measures	0.10	0.13	0.8	1.0
Subsidized employment	0.22	0.02	6.1	0.2
Measures for the disabled	0.55	0.03	0.2	0.2
Unemployment compensation	3.45	1.33	-	-
Early retirement ¹	0.29	-	-	-
Total	5.14	1.84	8.0	2.6

Note: ¹For labour market reasons.

Source: OECD (1999).

program of subsidized jobs, so-called Melkert jobs (named after the former minister of social affairs and employment). The aim is to provide 60,000 jobs for the long-term unemployed, for 32 hours a week, at the minimum wage or slightly above. There are also wage subsidies for the long-term unemployed: employers who hire long-term unemployed, hire people on wages less than 115 percent of the legal minimum wage and provide training schemes are entitled to a cut in their tax bill of up to 6,000 Dutch guilders per year (one Dutch guilder is about 0.43 Euro). All in all, the number of workers on socially purposeful jobs or on subsidized jobs increased by about 100,000 in the 1990s.

CONCLUSIONS

Both the UK and the NL have experienced a major decline in unemployment rates since the early 1980s. Furthermore, over the same period, the decline in unemployment rates was accompanied by a decline in non-employment rates. So, for both countries the declining unemployment is a real phenomenon and not just a result of a statistical redistribution of non-employed workers from unemployment to other categories. Since in most other EU-countries such a decline in unemployment did not occur to the same extent there is something of an unemployment miracle in both countries.

In both countries the driving force underlying the declining unemployment rates has been the significant reduction in equilibrium unemployment since the early 1980s. In both countries, the unemployment benefit system has become significantly less generous along with an increase in the pressure to take jobs. However, the NL has combined this change with an increase in expenditure on active labour market programs to help the unemployed which contrasts with a significant decline in such programs in Britain, at least up until 1996 (see Martin 1998, Table 1).

The success of the NL and the UK in bringing down unemployment from the disastrous heights of the early 1980s is a significant achievement. Some other aspects of the operation of their labour markets are less praiseworthy, notably the disability system. What, then, are the overall lessons which others might heed?

The recent history of the NL and the UK emphasizes the importance of *wage-bargaining* systems. Since 1983, the unions in the NL have been very cooperative and they operate within a highly coordinated wage-bargaining system. As a consequence, when the labour market starts to become tight, there is no excessive upward pressure on wages and this enables a low level of unemployment to be sustained. To a lesser extent, this has been achieved in the UK by reducing the wage-bargaining power of unions via legislation and also because of the weakness of the unions in the private sector. The Dutch method is probably more desirable, but the UK provides a lesson in a situation where bargaining is essentially decentralized and the institutions required for coordinated wage bargaining simply do not exist.

There is no question that the gradual restructuring of the *benefit systems* of the NL and the UK has helped their economies to sustain lower levels of unemployment. Both countries have reduced benefits and have made the work test stricter. As complements to this, the Dutch have introduced, and the British are introducing, active labour market policies targeted on the long-term unemployed, with a long-term view to eliminating this group. The New Deal programs in Britain aim eventually to intercept all unemployed individuals at a certain duration point and insist that they take up a work or training alternative. We feel that this kind of restructuring to help push the long-term unemployed into work is a step in the right direction. However, more generally on the benefits front, one of the most important lessons of the UK in the 1980s and 1990s, and the NL in the 1970s and 1980s, is that the disability and sickness benefit systems must be kept under control

with very stringent entry criteria. Over these periods, in both countries, there were enormous increases in the numbers on disability benefit which obviously did not correspond to secular declines in general health. The situation has now stabilized in the NL, albeit with very large numbers, but in the UK the figures are still rising. This whole debacle emphasizes how important it is not to succumb to the temptation to reduce labour supply as a policy response to increasing unemployment.

One of the features of women's employment in the NL and the UK is *employment flexibility* caused by the large proportion of part-time workers. Part-time work allows flexibility for both employers and employees and has enabled a very rapid build-up of female employment, particularly in the NL.

In the UK, but not in the NL, there is evidence that the equilibrium unemployment rate is higher than it need be because of a *skills mismatch*. The shortfall in the supply of skilled workers as the labour market gets tight generates inflationary pressure.

In conclusion, the unemployment rates in both the UK and the NL went down substantially because of a significant reduction of the equilibrium unemployment rate since the early 1980s. Combinations of supply-oriented policies are responsible for this. The combinations are partly overlapping and partly differing between the two countries. The main difference is in wage negotiations. Where the Dutch unions were already cooperative, British unions were made to cooperate. The main overlap is in the popularity of part-time work and the re-enforcement of financial incentives for unemployed workers collecting benefits. It is difficult to quantify the separate contribution of each of the policy changes. Freeman (1998) states that: "to the extent that configurations of institutions or policies matter, the proper comparison across countries is between entire models, not between particular features." We have basically three reasons for this. First, there is no empirical basis to disentangle the separate contribution of each

policy change. Second, some policy changes are time consuming and therefore time lags may be substantial. The NL started in the mid-1980s with the restructuring of the benefit system and is still busy implementing new elements. Third, policy changes are complementary. The effect of one policy depends on whether or not a different policy is implemented as well. In other words, a change of institutions in the labour market is a package deal.

NOTES

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¹The data for the Netherlands are data on registered unemployment. Registered unemployed are workers without a job or with a job of less than 12 hours per week, who are registered at a public employment office and are directly available for a job of at least 12 hours per week. From 1988 onwards the figures are based on the registration at the public employment offices and a monthly labour force survey held among about 10,000 people. The unemployment rate based on this information is about 0.3 percentage points higher than the International Labour Organization (ILO) unemployment rate. For the UK we use data from the labour force surveys, in order to calculate unemployment rates according to this definition. The unemployment rate according to the ILO-definition is currently about 1.5 percentage points higher than the official unemployment rates. This is mainly due to the fact that many unemployed married women are not entitled to benefits.

²In the calculation of the non-employment rates, jobs with a working time of less than 12 hours per week have been omitted. If these jobs were to be included the non-employment rate of males would decline by four percentage points, while the non-employment rate of

females would decline by ten percentage points. The share of these jobs with limited working hours has been quite constant during the 1990s. Most of the action for females is in the jobs of 12 to 34 hours per week.

³Early retirement is another explanation. In 1998 there were about 140,000 workers in an early retirement scheme, which is about 10 percent of the population in the age group 55-64 years. The number of workers in an early retirement scheme did not change a lot in the 1990s. In the United Kingdom, early retirement is not an official categorization.

⁴These numbers are reflected by the benefit statistics. For example, the number of prime-age men in receipt of Sickness, Invalidity and Incapacity Benefit more than doubled between 1989 and 1997 (see United Kingdom 1998, Table D1.04).

⁵The 6.1 percent of participant inflow related to subsidized employment is an average over the period 1994-97. In the first two years of this period the participant inflow was negligible, in the last two years it was about 12 percent of the labour force.

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