

EUROPEAN LABOUR MARKET REFORMS IN THE PERIOD 2000-2006

European labour market reforms in the period 2000-2006

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Introduction

The last decade saw a sizeable increase in the employment rate in the euro area, especially in specific population segments such as women and the over-54s.¹ Largely, these favourable results were the consequence of the reforms strategy promoted by the so-called Lisbon Agenda, which was set in train in 2000 and whose main aim – to increase the degree of competitiveness and dynamism in the European economy – required, among other elements, greater flexibility in labour markets and an increase in labour utilisation.

On this basis, this article seeks to identify the characteristics of the labour market reforms that have taken place in the euro area countries² in recent years, along with their potential effects. To do this it draws on the data in the European Commission's LABREF (labour market reforms) database.

The LABREF database includes qualitative information on all the legislative measures relating to labour markets adopted by the EU-27 Member States between 2000 and 2006. The measures span eight different areas: active labour market policies, employment protection legislation, welfare-related benefits, labour taxation, pensions, immigration/mobility, wage bargaining and working time. Each measure may be broadly targeted at the entire population or specifically at a particular socio-economic group. Moreover, the main expected impact of such measures may be on labour supply or demand, on wages or on potential mismatches between the unemployed and existing job vacancies.

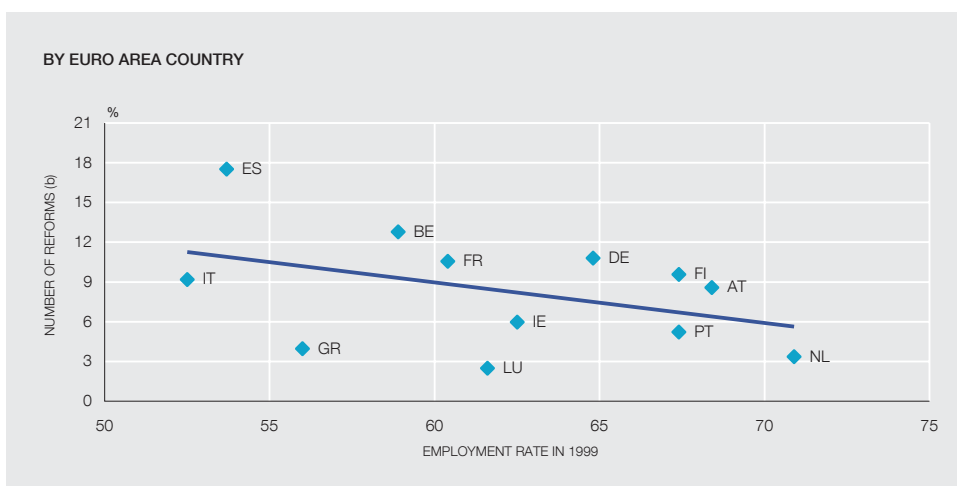
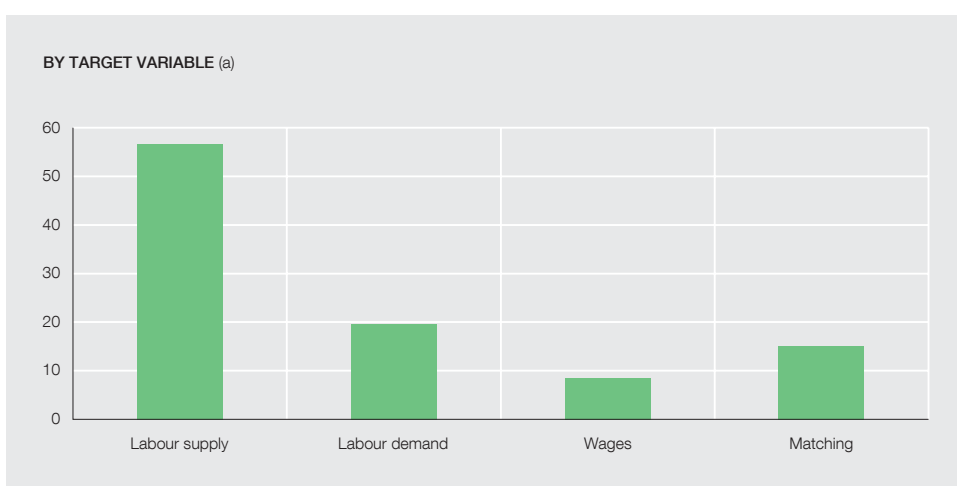
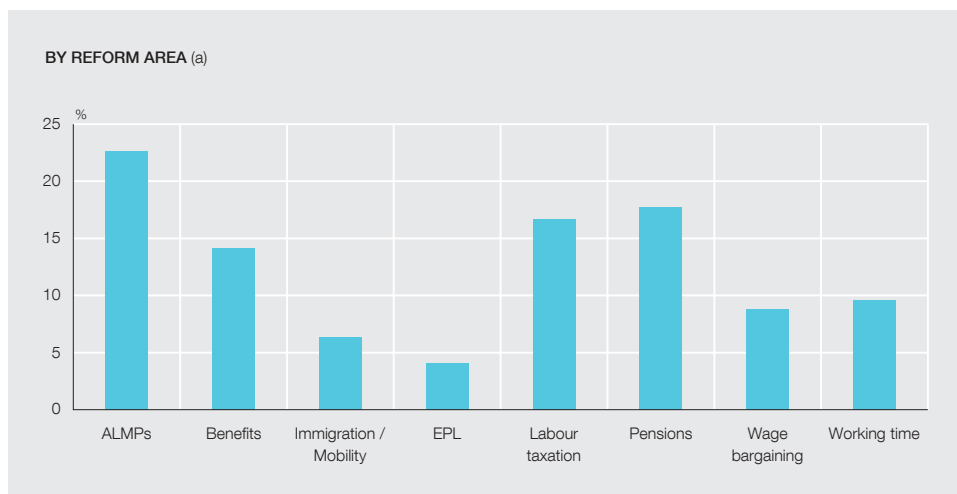
With this information, the article studies the thrust of the reforms in each field, identifying the areas where the reforming emphasis has been greatest for the euro area countries.

Labour market reforms in the euro area

The LABREF database allows for analysis of the fields on which the adopted labour market reform measures focused, along with their general characteristics. While the adoption of a larger number of measures in a specific area does not necessarily mean that reform has been more intense, it may be indicative of the priorities established. As Chart 1 shows, the areas in which most of the reforms have been undertaken in the euro area in the period 2000-2006 are active labour market policies, pensions, labour taxation and welfare benefits. The legislative measures relating to working time and to wage bargaining are in an intermediate position, while the number of reforms made in respect of employment protection legislation and immigration/mobility is substantially lower. If the measures are classified in accordance with the variable they seek to impact, most of them (56.7% in the euro area as a whole) have been aimed at increasing labour supply, which is due to the emphasis placed on modifying pension, benefit and tax systems. Labour demand (19.6%), the better matching of the skills of the unemployed to job vacancy requirements (15.1%) and, especially, wages (8.6%) have been less present among the objectives pursued by the reforms.

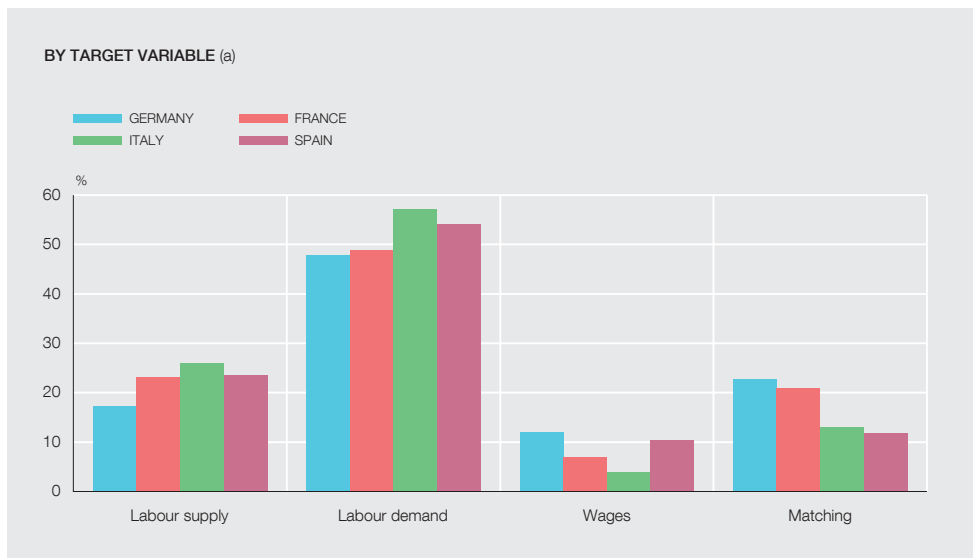
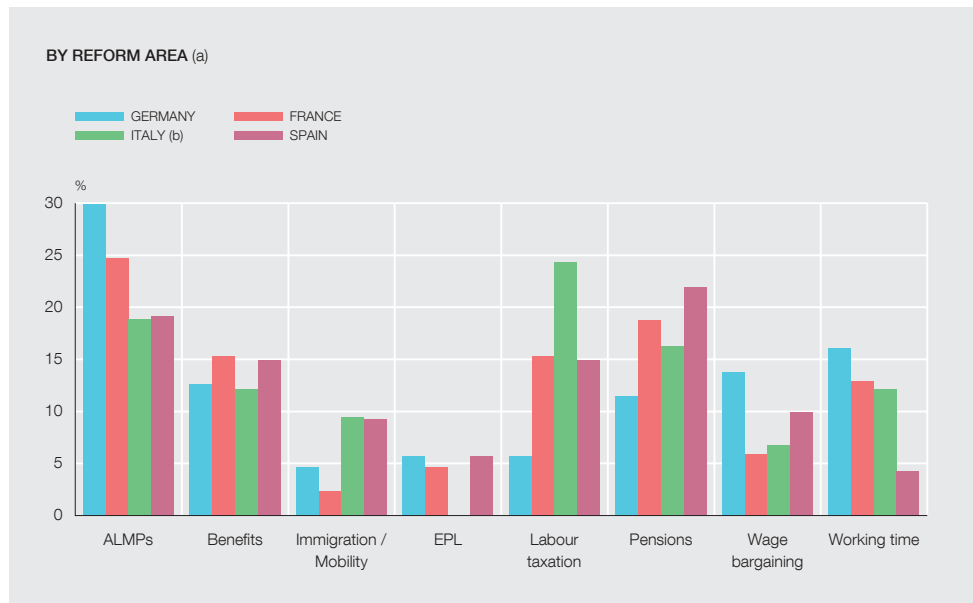
The countries departing from a lower employment rate in 1999 appear to have adopted a greater number of measures over the period, although this relationship is not very significant

1. See Moral and Vacas (2008). 2. Throughout the article, the analysis is of the 12-member euro area.



SOURCES: LABREF database (European Commission) and Banco de España.

- a. Number of reforms in each category as a percentage of all reforms in the euro area.
- b. Number of reforms in a particular country during the period as a whole, expressed as a percentage of all reforms in the euro area.



SOURCES: LABREF database (European Commission) and Banco de España.

a. Number of reforms in each category as a percentage of all the reforms in the country.

b. In the LABREF database there is no reform measure in Italy assigned to the EPL area. That said, initiatives have been implemented that may have reduced the level of job security (e.g. the introduction of new forms of more flexible hiring), but these have been assigned to the ALMP and working time areas.

and, above all, it does not necessarily mean that the resulting changes have been more profound. Comprehensive reforms have been few and far between, since each country has tended to focus its measures on specific areas (see Chart 2), which might have curtailed progress in making European labour markets adaptable to accelerating processes of change in productive and technological structures. Indeed, a broad labour market reform strategy enables the interaction between different labour institutions to be harnessed and, through laying down a long-term agenda with goals that are shared by the social agents and the government, it promotes a climate of confidence that helps raise the scope of the reforms and their viability.³

3. See Arpaia and Mourre (2005).

Furthermore, of the 805 legislative measures adopted in the euro area countries, more than half (454, i.e. 56.4%) were aimed at specific socio-economic groups among which the most common were older workers, low-income earners, women, youths and the long-term unemployed. Measures were, however, also geared to other groups such as the unskilled, immigrants, temporary workers, the self-employed or families with dependent children. This shows that, in general, European countries have opted to concentrate legislative actions on certain groups particularly affected by high unemployment rates rather than significantly altering the regulations that affect the core of the labour market.

In recent years, European countries have progressively increased the emphasis on *active labour market policies* (ALMPs), whereby the weight of such policies relative to the legislative measures undertaken has grown notably. While passive labour market policies consist of cash transfers that protect workers from situations entailing risk (benefits and early retirement pensions), active labour market policies include those social spending programmes whose aim is to raise the employment possibilities and to improve the earning potential of their beneficiaries. The European Commission⁴ distinguishes between seven types of ALMP: public employment services, training, job sharing and job rotation⁵, employment incentives (wage subsidies), supported employment and rehabilitation measures for persons with reduced working capacity, direct job creation (mainly in the public or non-profit sector) and start-up incentives.⁶ The strategy followed by many European countries has been to promote a closer relationship between ALMPs and unemployment benefit systems, in order to encourage active job search. The commonest reforms have entailed public employment services stepping up job placement efforts, with a tendency towards attending to the specific needs of each jobseeker; increased activation of the unemployed through compulsory participation in ALMP programmes (at an ever earlier stage), this being a pre-requisite, in some cases, for retaining benefits; a tightening of the job-search requirements for the unemployed and closer monitoring of their search efforts; and the more efficient administration of public employment services. By increasing the skills of the unemployed and encouraging an active job search to retain unemployment benefits, active policies may increase labour supply and improve its match with labour demand. Table 1 shows that average spending on ALMPs has grown in recent years, although their proportion relative to passive employment policies diminished between 1998 and 2006, apparently denoting a trend towards the selection of more useful ALMPs.⁷

In the area of *welfare-related benefits*, the biggest number of measures has centred on reducing the coverage or duration of unemployment subsidies, since sizeable cuts in such subsidies have been relatively rare. Accordingly, replacement rates (the ratio of benefits to previous earnings in work) have fallen in recent years. Also contributing to this has been the adoption of other measures that have established benefits at work or tax credits to strengthen the position of workers at a greater risk of labour market exclusion (especially the low-income earners and the low-skilled).⁸ As can be seen in Table 1, although in the initial stage of unemployment (first year) the average net replacement rate has increased slightly across the euro area between 2001 and 2005 (except for workers with higher earnings), the replacement rate has generally fallen over this period, especially for the highest earning groups. The intensity of the incentive effects of these measures de-

4. See European Commission (2006). 5. Measures that facilitate the insertion of an unemployed person or a person from another target group into a job by replacing some or all of the hours worked by an existing employee, who will reduce working hours or will be given full leave to receive training or for other reasons (e.g. maternity leave). 6. There are other classifications, such as that of the OECD, which includes five measures: expenditure on administration and public employment services, training geared to the labour market, special programmes for youths in transition from the education system to the labour market, employment-promoting programmes for the unemployed (subsidised employment) and special programmes for the disabled. 7. This reduction may also be due to the fact that the data do not include spending on public employment services, on which many measures have focused. 8. By increasing the wage received by the worker, these benefits or tax credits bring down the level of net replacement rates.

	Euro area		Germany		France		Italy		Spain	
	1998	2006	1998	2006	1998	2006	1998	2006	1998	2006
ACTIVE LABOUR MARKET POLICIES (ALMPs)										
Spending on ALMPs per unemployed person (a)	3.74	4.16	5.35	3.29	4.81	4.93	2.21	3.87	1.04	3.25
Ratio of spending on active/passive measures (b)	0.47	0.40	0.42	0.29	0.64	0.49	0.65	0.56	0.31	0.44
Continuous training participation (c)	5.4	8.2	5.3	7.5	2.7	7.6	4.8	6.1	4.2	10.4
WELFARE-RELATED BENEFITS										
Net replacement rates (d)										
<i>Initial phase of unemployment (e)</i>	69.0	69.5	73.8	73.3	74.3	71.5	62.8	72.3	74.3	73.5
<i>Long-term unemployment (f)</i>	45.6	44.7	62.8	52.0	44.5	43.7	16.3	16.2	35.7	35.3
<i>Average over 60 months of unemployment (g)</i>	56.2	55.5	65.7	61.9	63.8	60.6	5.5	6.5	49.7	49.2
Gross replacement rates (h)	34.3	32.3	29.4	24.2	43.5	39.0	34.1	32.5	36.5	36.0
Maximum duration of unemployment benefits (i)	24.2	16.3	12	12	60	23	6	7	24	24
EMPLOYMENT PROTECTION LEGISLATION (EPL)										
Total	2.5	2.4	2.5	2.2	3.0	3.0	2.7	1.9	2.9	3.1
<i>Permanent contracts</i>	2.5	2.5	2.7	2.7	2.3	2.5	1.8	1.8	2.6	2.6
<i>Temporary contracts</i>	2.5	2.3	2.3	1.8	3.6	3.6	3.6	2.1	3.3	3.5
Temporary employment ratio (j)	14.3	16.7	12.3	14.6	13.8	14.4	8.5	13.2	32.9	31.7
LABOUR TAXATION (k)										
Income tax	13.0	12.3	15.3	14.0	12.0	11.3	15.5	14.1	9.2	9.8
Social security contributions: employees	12.8	12.6	19.9	20.1	13.2	13.6	9.2	9.5	6.3	6.3
Social security contributions: employers	7.0	8.6	8.6	9.5	12.4	14.5	7.9	9.0	6.1	7.6
Tax wedge	38.0	36.4	46.0	44.7	44.9	43.9	41.1	39.2	35.1	35.6
PENSIONS										
Public spending on pensions (% of GDP)	12.8	12.7	12.8	13.1	13.4	13.3	14.9	14.8	9.6	8.9
Average relative income ratio (l)	0.9	0.86	0.97	0.93	0.90	0.90	0.96	0.85	0.91	0.75

SOURCES: Eurostat, OECD and Banco de España.

- a. Thousands of euro per unemployed person, at constant 2005 prices. Spending on public employment services is not included.
b. Spending on public employment services is not included.
c. Percentage of the population aged 25-64 that has participated in some training programme during the four weeks prior to conduct of the Labour Force Survey.
d. Ratio of net income when in an unemployment situation to previous earnings in work, calculated as a percentage of the wage of an average worker in the non-agricultural market economy (AW).
e. Average of net replacement rates in the initial phase of unemployment (first month of receipt of benefit) for six family types with previous in-work earnings equal to 100% of AW level.
f. Average of net replacement rates in the 60th month of unemployment (including social assistance, family and housing benefits) for six family types with previous in-work earnings equal to 100% of AW level.
g. Average net replacement rates over a five-year period of unemployment for six family types and two earnings levels (67% of AW level and 100% of AW level), including social assistance benefits.
h. Average gross replacement rates over a five-year period of unemployment for three family types and two earnings levels [67% of the wage of an average production worker (APW) and 100% of APW level].
i. Number of months. The initial data correspond to 1999.
j. Percentage of temporary workers with respect to the total number of employees. The final data correspond to 2007.
k. Average of eight family types, as a percentage of the gross annual wage.
l. Ratio of the income of persons aged 65 and over to the income of persons aged under 65.

depends, however, on the maximum duration of unemployment benefits, on their level and on the benefit eligibility conditions. The trend observed in most countries has been to tighten unemployment benefit requirements: greater work availability, restricting the possibilities of rejecting job offers for reasons of geographical distance, salary or incompatibility with the previous job; bigger sanctions if suitable job offers are rejected, the definition of which, moreover, has become looser; and stricter eligibility conditions, usually increasing the minimum period of work before qualifying for unemployment benefits. Finally, under this area of reform, other initiatives undertaken have involved establishing means-tested benefits, aimed at people with specific needs, and which have largely been linked to the family, especially for child-care support.

An example of this type of reform can be seen in the measures undertaken in Germany as part of the *Hartz* reform packages, between 2003 and 2005. The first pillar of these reforms focused

on improving public employment services by introducing market mechanisms such as, for example, the functioning of local employment agencies based on the calculation of their results, the potential outsourcing of some of their services (especially placement services) and the development of individual action plans to better assign the unemployed to the different programmes, depending on their particular profile. The measures further attempted to encourage greater involvement by the unemployed in job search and in enhancing their employability, tying the access to and maintenance of unemployment benefits (the level and duration of which, moreover, were cut) to their availability both to work and to participate in the job search activities and programmes assigned to them in their individual action plan. And, at the same time, monitoring by the public employment services was stepped up and sanctions tightened.

In the *immigration/mobility* area, there has been little action. Certain measures were undertaken with the aim of better incorporating immigrants into the labour market and of selecting them on the basis of their skills and of the needs of the recipient country. Frequently, however, initiatives have centred on border control and on other legal aspects regulating entry.

Employment protection legislation (EPL), which regulates hiring and firing rules, has been a very important tool in European countries' employment policies in recent years. Several studies suggest that greater flexibility in employment conditions may exert a clear and positive influence on the job prospects for those groups facing the biggest difficulties in joining the labour market. Conversely, stricter EPL, even though it were to favour the core of the labour market (by increasing job security), might adversely affect groups whose employment possibilities are lower when the market is less dynamic, such as women, youths or older workers.⁹ Few measures have been adopted in this area in the period 2000-2006, which is partly due to the fact that many of the initiatives were already adopted earlier, when the strategy followed by many countries – for instance Italy and Spain – was to increase labour market flexibility through the resort to temporary employment (for which the EPL, moreover, has favoured this growing flexibility), while regulations for more standard contracts were left practically unchanged. The resulting segmentation may have had an adverse effect on productivity, by having restricted access to training for workers with more flexible contracts in low-skilled jobs. For this reason, the European Commission is seeking to enhance *flexicurity* strategies to help bring about more inclusive labour markets where the barriers between the different groups are lower, by establishing, among other instruments, more balanced EPL between the different types of contract and appropriate access to continuous training for all workers.¹⁰

Among the measures undertaken in this field during the period under analysis, it is worth mentioning the lifting of the restrictions on the use of temporary contracts in specific industries in Germany; the introduction of a new form of temporary contract (with a maximum duration of 18 months, renewable once) aimed at the unemployed aged 57 or more who have been so for more than three months, and the progressive phasing out of the so-called “Delalande contribution” (a tax that companies had to pay in the event of dismissing workers aged 50 or more) in France; and the measures implemented through the Biagi legislation in Italy, aimed at adding flexibility to specific contracts already in use (such as part-time and apprenticeship contracts) while establishing new forms of employment for temporary workers.

As regards *labour taxes*, these have moved fairly uniformly across the euro area countries, tending to diminish as a means of increasing employment levels. Income tax has fallen slightly

9. Several studies highlight the fact that strict EPL might have a positive impact on productivity, since more stable industrial relations increase the readiness of employers to invest in training for their workforce. 10. For a detailed analysis of *flexicurity* strategies, see González Mínguez and Vacas (2007).

over the period 2000-2007 in most countries, and has done so more for low-income earners, for example, in countries such as France or Italy. Employees' social security contributions have held virtually stable for the euro area on average, although there has been significant disparity from country to country. Conversely, employers' social security contributions have increased in all countries, despite the fact that measures focusing on reducing the contributions paid by those who hire individuals belonging to specific groups with a lower probability of joining the labour market (women, youths, the over-54s and the long-term unemployed) have been commonplace, aimed at increasing their job prospects. Consequently, the tax wedge¹¹ has fallen over the period in most euro area countries and the biggest reductions have come about amongst the weakest groups. This is mainly due to an attempt to increase the demand for these groups of workers, as well as their supply; by reducing the difference between gross wages and wages actually received, employees will have greater incentives to accept a job offer or to increase their working hours. This is particularly relevant in the case of low-skilled or low-wage workers, such as youths and women who, faced with high tax wedges, will have fewer incentives to exit, respectively, the education system or housework.

Pension systems have been subject to major reforms in most euro area countries as a result of the pressure exerted by an increasingly ageing population with a greater life expectancy together with still-low employment and participation rates, especially among the over-54s (a group to which greater emphasis was given under the Lisbon strategy). Although there are Member States where changes in this field have been non-existent or few and far between, in some the reforms have been far-reaching, while other countries have adopted a series of measures of a lesser scope, but which, taken as a whole, have an impact on future pension entitlements.¹² In these cases the reforms point to an increase in the incentives to retire later and to a reduction in the pensions expected by workers (compared with previous generations), with the aim of ensuring financial sustainability in the long run. The measures adopted reflect the particularities of the different public pension systems, but generally they have involved increases in the number of years of contributions needed to qualify for a full pension, reductions in pensions when early retirement is taken or increases in pensions if employees continue working after the normal retirement age (as established, for example, by the *Fillon* law in France in 2003); changes in the way in which earnings are measured to calculate the level of pensions, extending the earning period considered, without restricting it to the final or best years of contributions; increases in the legal retirement age; a better tailoring of pensions to greater life expectancy; and changes in the way pensions are updated, linking their annual rises increasingly to inflation, instead of to wage growth.¹³ As a result of these reforms, there have been reductions in gross replacement rates (i.e. the ratio of pension level to the wage received before retirement) and in promised future pensions, more contained real increases in pensions than in the past and, generally, lesser incentives for early retirement.

Labour cost *flexibility*, which measures the responsiveness of wages to labour market conditions and to individual productivity, is related among other factors to the degree of centralisation and coordination in collective wage bargaining and to union density, insofar as these variables influence the level of minimum wages or the presence of wage indexation. Since the creation of the euro area, the growth of labour costs has moderated, contributing to containing inflation and to macroeconomic stability. And that may have had a bearing on the positive trend of the labour market in recent years. However, this moderation has, in some cases, been

¹¹ The difference between gross labour costs for employers and disposable income for employees, which is the sum of personal income taxes and both employers' and employees' social security contributions, minus cash benefits, expressed as a percentage of gross labour costs. ¹² Among the former are Spain, Greece, Belgium and Luxembourg. The euro area countries where the biggest reforms were made are Austria, Finland, France, Germany, Italy and Portugal. ¹³ See OECD (2007).

the outcome of particular deviations from State-wide collective bargaining agreements rather than of changes in national incomes policies. That is to say, although in practice wage bargaining has been decentralised to some extent in several countries, there have been few broad reforms to collective bargaining systems so that wages respond more directly to changes in productivity at local and firm level.

Another dimension of labour flexibility relates to the organisation of working time, by allowing firms to adjust employees' working hours to conjunctural needs and workers to reconcile their working life with other social activities, such as family or training. This flexibility has come progressively more to the fore in recent years in almost all euro area countries, thanks to various measures that have sought to increase it: more flexible management of the maximum permitted working hours and of their distribution over a longer period, and also of overtime; an increase in entitlements relating to voluntary part-time work; more flexible business hours; maternity leave; sabbatical years; paid leave, etc.

This review of measures adopted shows that, in general, the reforms aimed at increasing active labour market policies, improving the sustainability of public pension systems, reducing the labour tax burden (especially for lower wages) and liberalising temporary employment have been more profound than those undertaken in respect of the generosity and duration of unemployment benefits or in the area of permanent employment contracts.¹⁴ Overall, the reforms appear to have had a positive impact on the euro area, since the aggregate employment rate increased by 5.6 pp between 1999 and 2007 (see Table 2). Further, these developments in employment can largely be explained by the bigger increase in women and the over-54s (not so much youths, partly because they remain longer in the education system), which would mean that the European strategy of reforms aimed at promoting the active participation and hiring of the weakest socio-economic groups in the labour markets has been successful.¹⁵

Conclusions

The Lisbon European Council summit in 2000 set the strategic objective of making the EU “the most competitive and dynamic knowledge-based economy in the world”. To achieve this objective, it was considered essential to increase the degree of labour utilisation, which had been identified as one of the key elements in explaining per capita income growth differences between the United States and the European economy in the 1990s. In this respect, targets were set in terms of the employment rate (both for total population and for different population groups), as part of the overall strategy known as the Lisbon Agenda. Compliance with these targets required the introduction of major labour market reforms by most European countries.

This article has drawn on the European Commission's LABREF database, which contains qualitative information on all the labour market legislative measures adopted by the EU-27 Member States in the period from 2000 to 2006, in order to identify what the main areas of labour market reform in the euro area were in this period. Broadly, although many legislative measures were introduced (which does not necessarily attest to their scope and depth), most countries tended to focus their efforts on specific labour market institutions. The areas in which the largest number of reform initiatives were taken were active labour market policies, pension systems, labour taxation and welfare benefits, while few measures were introduced in areas such as employment protection legislation, working time and wage bargaining. The absence

¹⁴. On the intensity of reforms in the different areas, see also Brandt, Burniaux and Duval (2005). ¹⁵. The European Commission (2008) performs a simple analytical exercise in an attempt to quantify the impact of these reforms targeting specific groups of workers.

% levels	1999	2000	2001	2002	2003	2004	2005	2006	2007	Target 2010 (d)	Change 1999-2007
TOTAL (a)	70.0										
EURO AREA	60.1	61.3	62.0	62.4	62.7	62.8	63.8	64.8	65.7		5.6
Germany	64.8	65.3	65.7	65.4	64.9	64.3	66.0	67.5	69.4		4.6
France	60.4	61.7	62.7	62.9	64.0	63.4	63.9	63.8	64.6		4.2
Italy	52.5	53.4	54.5	55.4	56.1	57.7	57.6	58.4	58.7		6.2
Spain	53.7	56.1	57.7	58.6	59.7	60.9	63.3	64.8	65.6		11.9
WOMEN (a)	60.0										
EURO AREA	49.8	51.2	52.2	52.9	53.8	54.3	55.7	56.8	58.0		8.2
Germany	57.1	57.8	58.7	58.8	58.9	58.5	60.6	62.2	64.0		6.9
France	53.5	54.8	55.7	56.4	58.4	57.7	58.5	58.8	60.0		6.5
Italy	38.1	39.3	40.9	41.9	42.8	45.2	45.3	46.3	46.6		8.5
Spain	38.2	41.2	42.8	44.3	46.1	47.9	51.2	53.2	54.7		16.5
OLDER PERSONS (b)	50.0										
EURO AREA	33.7	34.1	34.7	36.1	37.5	38.3	40.6	41.8	43.4		9.7
Germany	37.8	37.4	37.7	38.4	39.4	41.4	45.4	48.4	51.5		13.7
France	28.4	29.4	30.7	33.8	36.1	37.3	38.7	38.1	38.3		9.9
Italy	27.5	27.3	26.9	28.6	30.0	30.2	31.4	32.5	33.8		6.3
Spain	34.9	36.8	39.1	39.7	40.8	41.0	43.1	44.1	44.6		9.7
YOUNG (c)											
EURO AREA	35.3	36.6	37.2	37.1	36.8	36.2	36.8	37.3	38.0		2.7
Germany	46.2	46.1	46.5	45.4	44.0	41.3	42.2	43.4	45.3		-0.9
France	26.4	28.2	29.3	29.9	31.4	29.9	30.7	30.2	31.5		5.1
Italy	25.5	26.1	26.2	25.7	25.4	27.6	25.7	25.5	24.7		-0.8
Spain	29.8	32.2	33.6	33.8	34.2	34.7	38.3	39.5	39.1		9.3

SOURCE: Eurostat.

- a. Population aged 15-64.
- b. Population aged 55-64
- c. Population aged 15-24.
- d. Lisbon Agenda employment targets.

of comprehensive reform packages has restricted headway in making euro area labour markets more flexible, as this means the complementarities between different labour market institutions cannot be harnessed and that the necessary cooperation between social agents to agree on deeper reforms is not enhanced.

The European countries have tended to direct most of their initiatives at increasing labour supply (and, to a lesser extent, also labour demand) in respect of specific groups such as youths, women or the over-54s, who evidence the lowest labour market participation. Conversely, the legal regulations affecting the core of the market have remained relatively intact.

This European strategy of labour market reform has obtained favourable results, as reflected in the substantial job creation and the increase in employment rates in the period under analysis, especially for certain population groups. However, many countries remain far off meeting the targets set in the Lisbon Agenda, which highlights the importance of furthering labour market reforms, particularly to overcome the current, difficult economic setting, characterised by the strong contraction in growth. In such circumstances, greater labour market flexibility is an essential ingredient for increasing the adjustment capacity of the European economies in the face of the serious shocks affecting them. And this is all the more necessary within the context of membership of a monetary union.

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