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# **The Austrian Labor Market: Model of Success or Increased Need for Reforms?**

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## **1. Introduction**

Due to persistently high unemployment rates, the labor market found itself again at the center of political attention in the 1990s. Strategies and recommendations in terms of economic policy were developed to reduce unemployment and to increase employment rates. In this context, the Organisation for Economic Co-operation and Development (OECD) Jobs Strategy and the European Employment Strategy have to be mentioned. Both approaches are comprehensive reform strategies aiming at a sustainable increase in employment and reduction of unemployment. At the Lisbon Summit (March 2000), the European Union developed a new economic policy strategy with the goal of increasing Europe's competitiveness and innovative power as well as generating sustainable economic growth entailing more and better jobs and greater social cohesion. Goals are to raise the general employment rate in the EU to 70% and to increase the proportion of women in employment to 60% by 2010. In 2005, the Lisbon Strategy was revised and the goals of stronger and sustainable growth as well as the creation of additional and better jobs became the new focus. From that time on, employment guidelines have been presented in connection with macroeconomic and microeconomic guidelines and together form the basis the EU's Lisbon Agenda and National Reform Programs.

In the international literature<sup>1</sup>, several European countries can be found as examples of successful reform efforts (U.K., Netherlands, Denmark, Ireland). Thus, for example, the OECD identifies Denmark, Finland, and the Netherlands as successful countries which have carried out consistent and comprehensive reform programs in the last few years (cf. Brandt et al. 2005). The different approaches in those reform strategies notwithstanding, all those countries managed to significantly reduce previously high unemployment rates. Austria is also regarded as one of the countries showing comparatively favorable job market performance, and – in contrast to the countries mentioned above – it has managed to keep its

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<sup>1</sup> Cf. for example Nickell and van Ours (2000), Auer (2000).

unemployment rate at a relatively low level, even if this rate has been increasing slightly but continuously over the last 25 years.

Pichelmann et al. (1998) identify, among other things, the following “success factors” which have contributed to Austria’s favorable labor market performance:

- Economic policy focusing on macroeconomic stability
- High degree of macroeconomic real wage flexibility
- The dual system of apprenticeship training for adolescents
- Not overly generous system of unemployment benefits (with the exception of the problem of cross-subsidies in seasonal industries)
- Elastic reaction of labor supply to cyclical fluctuations in employment

The goal of this contribution is the discussion of the development of the Austrian labor market, in particular its problem areas, as well as new challenges against the backdrop of the economic policy recommendations issued by the OECD and the European Commission. A comprehensive evaluation of the OECD Jobs strategy and the Lisbon Strategy, even from an Austrian perspective, would go far beyond the scope of this contribution. Instead, I will focus on the OECD’s economic policy recommendations to the extent they concern the labor market as well as on the EU’s evaluation of the Austrian reform program under the Lisbon Strategy, and I will discuss the challenges of the Austrian labor market from my own personal point of view. I concentrate on the “pure” labor market recommendations, which by no means, however, implies that growth, macroeconomic environment as well as the promotion of entrepreneurship should not have an impact on the labor market. On the contrary, labor market oriented strategies are only apt to increase employment or reduce unemployment if companies offer additional jobs. This has to be borne in mind for all statements that follow.

Section 2 shows Austria’s labor market situation in an international context. Section 3 looks at the recommendations and implementations of the OECD Jobs strategy and discusses the European Commission’s most recent recommendations concerning the Austrian implementation of the Lisbon Strategy. Section 4 discusses the development of unemployment by education level as well as the cyclical elasticity of labor supply. The last section then deals with weaknesses and new challenges of the Austrian labor market.

## **2. Development of the Austrian Labor Market**

By international comparison, the current situation of the Austrian labor market can be described as favorable. If one takes the indicator of unemployment, Austria shows an unemployment rate of 5.2% for 2005 according to Eurostat, compared to 7.8% and 8.5% for the EU-15 and the euro area, respectively. Over time, the performance of the Austrian labor market is less favorable (see table 1), but it is

important to take into account certain statistical effects here<sup>2</sup>. In the reference year of 1997, Austria still ranked first among the EU-15, according to Eurostat. In 2005, Austria with its rate of 5.2% is still among the leading countries, but has slipped to fifth position, with the gap to the top performers (with the exception of Ireland), however, being no bigger than 0.5%. Taking the OECD's structural unemployment rate (NAIRU) as a reference, there is no deterioration in absolute terms, while the positive gap in relation to the EU average has decreased by about a half percentage point (see chart 1).

*Table 1: Unemployment Rates EU-15 1997 and 2005*

<b>Austria</b>	4.4	Ireland	4.3
Netherlands	4.9	U.K.	4.6
Denmark	5.2	Netherlands	4.7
Portugal	6.8	Denmark	4.9
U.K.	6.8	<b>Austria</b>	5.2
Germany	9.1	Sweden	6.3
Belgium	9.2	Portugal	7.3
Greece	9.8	Italy <sup>1)</sup>	8.0
Ireland	9.9	Finland	8.3
Sweden	9.9	Belgium	8.4
Italy	11.3	Spain	9.2
France	11.5	Germany	9.4
Finland	12.7	France	9.5
Spain	17.1	Greece <sup>1</sup>	10.5

<sup>1)</sup> 2004: Greece, Italy.

Source: Eurostat.

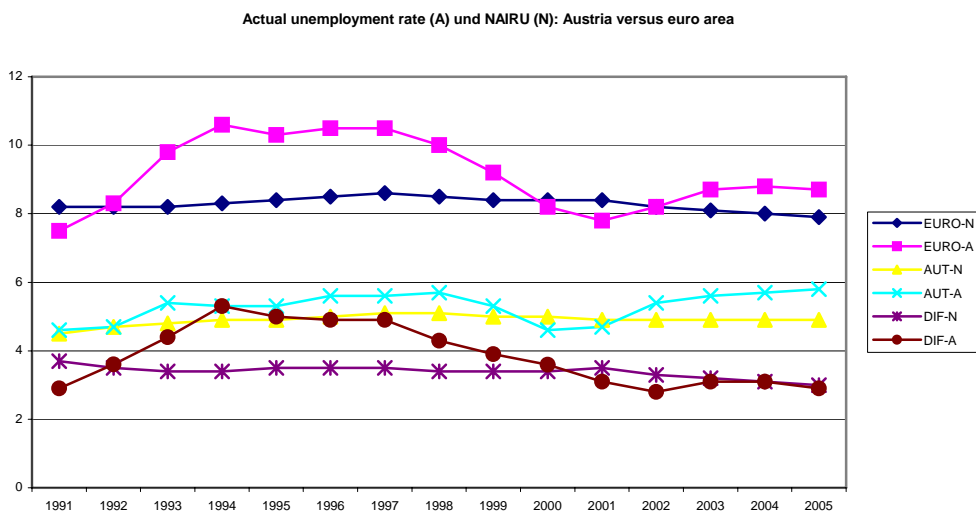
For the domestic discussion, the development of the unemployment rate pursuant to the national definition is used (see chart 2). If this is adjusted by seasonal and cyclical factors<sup>3</sup>, a similar, albeit slightly worse picture emerges. From a more long-term perspective, a steady increase in the number of reported unemployed can be stated. Only in the second half of the 1990s did that number, due to the booming economy, decline significantly. With the economy starting to stagnate at the beginning of this century, the trend in unemployed persons has shifted upwards

<sup>2</sup> The changes in methods in the labor force survey (microcensus) of 2004 (cf. Kytir and Stadler, 2004), e.g., sample design and survey period, led to a time-series break. It is reasonable to assume that unemployment within the microcensus was underestimated prior to 2004. This always has to be borne in mind for long-term comparisons.

<sup>3</sup> In terms of methodology, the trend component was determined based on the Hodrick-Prescott (HP) filter.

again. Compared to 1997, the current unemployment rate has increased by about a half percentage point. If the “extended unemployment rate” according to the IHS definition<sup>4</sup> is examined, a slightly stronger increase can be noted. Overall, however, all definitions suggest that Austria continues to hold a good position by international comparison, even if a negative tendency can be stated at least for the national rate.

*Chart 1: Actual and Structural Unemployment Rate (NAIRU):  
Austria and Euro Area*



Source: OECD.

The absolute increase in dependent employment can be seen as favorable. According to the Association of Social Insurance Providers, the number of people in active dependent employment (excluding recipients of maternity leave or child-care benefits as well as persons fulfilling their compulsory military service) has risen by about 155,000, or 5.2%, since 1997, with almost the entire increase being accounted for by female employees (148,000 people, or 12%).

<sup>4</sup> The numerator was extended by participants in training courses, while from the denominator recipients of maternity leave or child-care benefits as well as persons fulfilling their compulsory military service were excluded. The unemployment rate is calculated as the ratio between unemployed and course participants on the one hand and unemployed, course participants and actively employed on the other. This rate must, by definition, be above the national unemployment rate.

At 67.8%, the employment rate for 2004 was above the EU-15 average of 64.7% according to Eurostat (see table 2). The employment situation for people over 55 is still not encouraging, with the corresponding rate of 28.8% being far below the EU average of 42.5%. What is positive, however, is the situation regarding long-term unemployed with a rate of 1.2%, which is unchanged from 1997, while this rate has decreased from 4.8% to 3.4% in the EU-15. A significant deterioration was noticeable for youth unemployment, with that rate rising from 6.7% to 9.7%. At this rate, Austria is still far below the EU-15 average of 16.6%, but the structural problems regarding youth employment are becoming ever more transparent.

*Table 2: Labor Market Indicators Austria and EU-15*

	Austria		EU-15	
	1997	2004	1997	2004
<i>Unemployment rate</i>	4.4	4.8	9.9	8.1
youth 15–24	6.7	9.6	20.7	16.7
<i>Employment rate</i>	67.8	67.8	60.7	64.7
older employees 55–64	28.3	28.8	36.4	42.5
<i>Long-term unemployment rate</i>	1.3	1.3	4.8	3.4
<i>Women</i>				
<i>Unemployment rate</i>	5.4	5.3	11.8	9.3
<i>Employment rate</i>	58.6	60.7	50.8	56.8
older employees 55–64	17.0	19.3	26.1	33.2
<i>Long-term unemployment rate</i>	1.6	1.4	5.9	4.0
<i>Men</i>				
<i>Unemployment rate</i>	3.6	4.4	8.4	7.2
<i>Employment rate</i>	77.1	74.9	70.6	72.7
older employees 55–64	40.3	38.9	47.2	52.2
<i>Long-term unemployment rate</i>	0.9	1.3	4.0	3.0

*Source: Eurostat.*

Chart 2: Structural Unemployment Rate in Austria (National Definition)

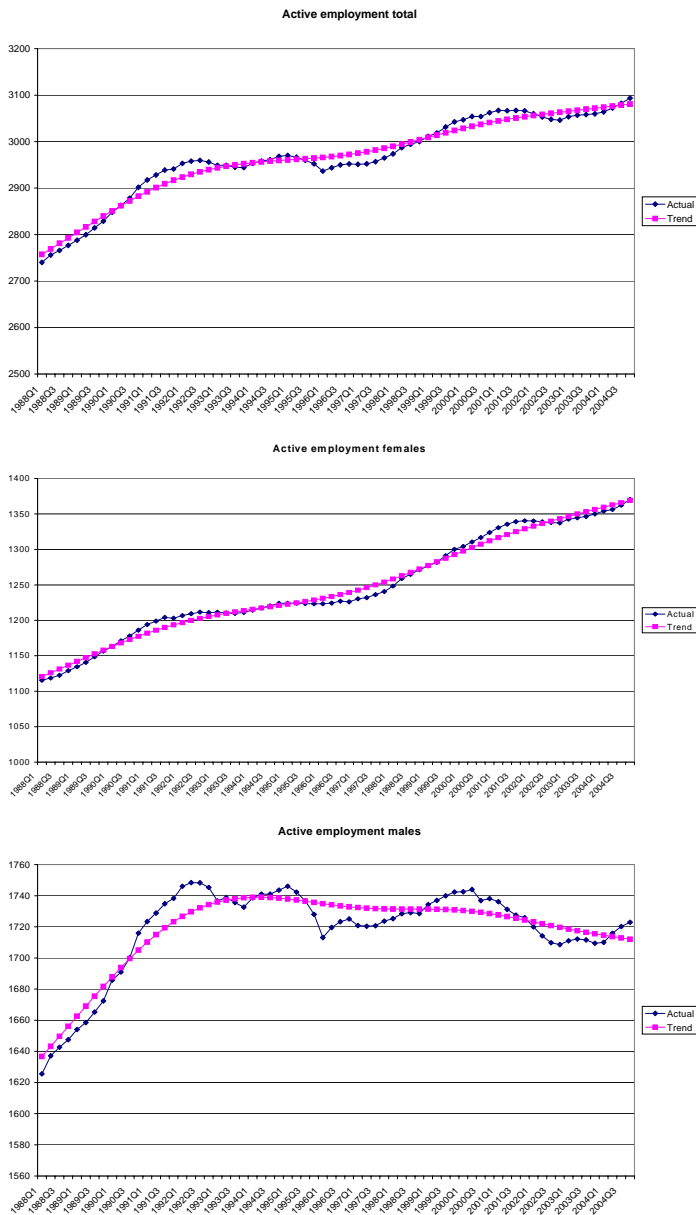


Source: Author's calculations.

Chart 3 shows the long-term development of employment in Austria. In order to outline the trend in employment independent of short-term cyclical fluctuations and institutional changes, the development concerning dependent actively employed and the corresponding trend (adjusted for cyclical fluctuations) is shown. Looking at the period starting from the mid-1990s, trend employment has been rising continuously. However, the employment situation has developed completely differently if looked at in terms of gender. While employment among men has been stagnating or even slightly declining, women have experienced a marked increase in employment. A significant share of this increase was accounted for by part-time positions<sup>5</sup>. According to the micro-census, already a third of all female employees were working a maximum of 30 hours per week in 2003. This represents an increase in the part-time rate among women of 7.3 percentage points from 1997 to 2003 (cf. Hofer et al., 2005).

<sup>5</sup> In this context, "part-time" covers all employment agreements between 1 and 30 hours per week.

Chart 3: Active Employment Trend and Actual Employment by Gender



Source: Association of Social Insurance Providers, compiled by the author.



### 3. Economic Policy Recommendations by OECD and EU Commission

#### 3.1. The OECD's Jobs Strategy

The OECD's Job Study (1994) examines the reasons for the high and persistent unemployment in the late 1980s and early 1990s of the 20<sup>th</sup> century. Based on those analyses, a number of comprehensive economic policy recommendations were formulated to improve the labor market situation. These recommendations aim at increasing the abilities of economies and societies to cope with structural change by improving their adaptive and innovative capacities. The economic policy guidelines encompass ten broad areas, namely economic policy on a macro level, innovation and diffusion of technology, favorable entrepreneurial climate, promotion of competition in product markets, increase of the human capital potential of employees, as well as various aspects concerning the labor market. These 10 broad economic policy guidelines with a total of 70 detailed recommendations form the so-called OECD's Jobs Strategy (cf. Brandt et al., 2005).

In the following, I would like to concentrate on the areas directly related to the labor market and discuss the recommendations and their implementations for Austria. Specifically, these are the following guidelines:

- Increase working time flexibility;
- Make wage and labor cost more flexible in such a way that wages correspond to local conditions and the employees' level of education and training, in particular for young employees;
- Reform employment protection legislation (EPL) if such legislation hinders an increase in employment in the private sector;
- Raise the significance of active labor market policy and increase its effectiveness;
- Increase the technical skills and expertise of employees by means of reforms in the education and training system; and
- Reform unemployment and related benefits systems – while taking into account interactions with the tax system – in order to reach goals of social equality with only minor disruptions to the efficiency of the labor market.

Brandt et al. (2005) provide an overview of reform efforts in the OECD countries within the last 10 years and discuss to what extent they conform to the recommendations of the OECD's Jobs Strategy. This shows that many states have implemented reforms, with comprehensive reform efforts to be found in particular in Denmark, France, and the Netherlands. Only few reforms, however, have been implemented in the Czech Republic, Iceland, Japan, Mexico and Switzerland. One needs to bear in mind, however, that the need for reforms depends strongly on the

starting position of the individual countries. According to the OECD scale, Austria ranks eighth in terms of its reform efforts.

The reforms of the OECD countries are spread unevenly across individual political areas. Governments have primarily lowered labor taxes, deregulated temporary employment contracts, and taken measures to activate unemployed people. On the other hand, there were hardly any reforms concerning standard employment contracts or the unemployment and related benefit systems.

As for Austria, increased reform efforts can be noted in terms of taxes and social security contributions as well as the pension sector. A comparatively high level of reform activity can also be found in the field of unemployment insurance, while there were virtually no reforms in the wage-formation process (cf. Brandt et al., 2005).

It is interesting to compare Austria's reform efforts to the OECD's recommendations (cf. Brandt et al., 2005, annex 2). It can be noticed that there are a number of political areas where reforms were carried out without country-specific recommendations from the OECD. However, there are also areas where no reforms were initiated despite such recommendations.

The efforts to reduce labor taxes are regarded as positive, even if there was no country-specific recommendation by the OECD in this area.

As for EPL, there were recommendations concerning the reform of dismissal protection regulations and temporary employment contracts. There were two reforms in the first area affecting older employees. While the introduction of a penalty upon dismissal (1996) was rated as negative, the extension of the waiting period after commencing employment for increased employment protection from 6 months to a year (2001) is in line with the OECD's Jobs Strategy. Positive reactions were triggered by the introduction of "Severance Pay – New", loosened regulations for temporary employment in tourism and agriculture, as well as the permission for private job agencies to act as temporary work agencies.

In the field of active labor market policy, the extension of the relevant programs is in conformity with the recommendations. The increased target group orientation (youth programs) was also evaluated positively, although no recommendation was given in that area.

From the OECD's point of view, reform efforts in the field of unemployment insurance were seen as positive. In this context, the OECD mentions changes in the calculation of the replacement rate as well as the tightening of the provisions governing acceptability of jobs, even if there were no recommendations in these fields. Allowing brief employment periods during unemployment without negative financial consequences is in conformity with the recommendations. The same is true for the pension reform.

Recommendations were issued for the areas of industrial relations and wage determination as well as the increase in work time flexibility, but hardly any reforms were carried out. This applies to the field of wage formation in accordance

with education, training, experience and productivity, the use of opt-out clauses and flexibility in terms of part-time employment.

I would now like to deal with the labor-market related recommendations in the OECD Country Report for Austria (2003 and 2005) and comment on them. In the area of raising flexibility of wage and labor cost, the OECD recommends an increased application of opening clauses in the wage formation process as well as better consideration of the specific situation of older employees. Macroeconomic real wage flexibility<sup>6</sup> is still high in Austria, but there are indications of rigid relative wage structures (cf. Hofer et al., 2001), such as returns to education as well as industry and gender-specific wage differentials. Furthermore, relative wage mobility<sup>7</sup> is comparatively low in Austria (cf. Hofer and Weber, 2002). Thus, an increase in wage flexibility on a company level, in particular in line with productivity, might yield positive effects.

As regards working time flexibility and employment protection, the OECD suggests abolishing the part-time allowance for older workers. Partial retirement regulations only make sense if they allow older employees to remain employed for longer by reducing their working hours. As subsidizing early retirement pensions is not approved of, the possibility to frontload work in the phased retirement program should be eliminated altogether.

As for the reduction of incentives for early retirement, the OECD demands a review of the entitlement conditions for invalidity pensions. The government's efforts so far in terms of extending life working time must be viewed as absolutely positive. The current pension reform has not led to a significant increase in the unemployment rate among 50 to 65-year-olds. However, the strong increase in invalidity pension must be regarded as problematic, entailing the necessity of a reform of invalidity pensions. However, it will also be necessary to rethink tasks that are demanding on the health of employees. Thus, the OECD requires incentives also for employers to reduce the probability of industrial injuries as well as occupational diseases. Measures to prevent invalidity must set in at an early stage. Applications of the active aging concept (e.g. reduced shift work) are to be viewed as positive and should be expanded. More flexibility in terms of job mobility is also required (e.g. from construction worker to receptionist).

The OECD has expressed some skepticism as regards the extent to which seasonal workers claim unemployment insurance. In general, Austria is marked by a very high level of seasonal unemployment, which can to some extent be put down to the design of unemployment insurance (cf. Felderer et al., 1999). This is not limited to the construction and tourism industries but affects other economic

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<sup>6</sup> This denotes the reaction of real wages to external or internal supply shocks. The direct impact of unemployment of wage formation may be taken as an indicator, for example.

<sup>7</sup> Wage mobility measures the changes in relative income positions of an employed person within a certain period of time.

sectors as well. From my point of view, therefore, consideration should be given to introducing experience rating in the unemployment insurance system.

In addition, the OECD suggests the reduction of effective marginal tax rates for low incomes. Furthermore, it demands the introduction of employment-based transfers in conjunction with more pronounced wage differentiation. Austria is also faced with the problem that unemployment is highest among least-qualified workers, while the activity rate is low at the same time. A reduction of social security contributions for low-income earners could improve their chances of employment. It must be taken into account that distribution goals can be achieved more easily through the tax system rather than by direct market intervention, which might entail negative consequences on employment. In the long run, subsidizing or creating a low-wage sector must be seen as problematic, however, as this would lead to a reduction in the incentives to acquire human capital.

Furthermore, the OECD recommends a modernization of the dual vocational training system, but is skeptical in terms of financial subsidies. The OECD wants to ensure that the apprentice foundations convey qualifications that are sought after by the market. I consider a further modernization of the apprentice system to be necessary. In the short, it would be possible to generate additional apprenticeship positions by massive financial subsidies (Blum bonus), but such a system would not be financially viable in the long run. Rather, it is necessary to increase efforts to improve the technical and social skills of apprenticeship seekers.

### **3.2 Lisbon Process and European Employment Strategy**

The European Employment Strategy (EES) was initiated in 1997 with the goal of significantly reducing unemployment in Europe within five years. Originally, the EES was based on four pillars (employability, entrepreneurship, adaptability, and equal opportunities). Using employment policy guidelines as a starting point, the Member States developed national action plans for employment (NAP), which were evaluated by the Commission and the Council in so-called Joint Employment Reports (JEP).

Those JERs evaluate the measures to implement the country-specific employment policy recommendation and discuss challenges for the employment policy of the individual Member States. In general, the Employment Reports consider the Austrian strategy to be in conformity with the EU's central employment policy issues. Weaknesses seen to exist in Austria include the low employment rate and above-average unemployment rate for older people, which are put down to deficits in the area of life-long learning and the traditional policy of early retirement (JER 1999, 2000, 2001). Gender-specific differences in terms of labor force participation rate and income are addressed on several occasions. The low labor force participation rate among women is put down to a lack of child-care facilities (JER 2000, 2004/5). Similarly, attention is drawn to the big gender-

specific wage differences (JER 2000, JER 2001, JER 2003/4, JER 2004/5). Furthermore, the insufficient integration of migrants is criticized (JER 2000). The expansion of active labor market policy (JER 2002) and the pension reform (JER 2003/04) are evaluated as positive. The 2004/05 JER regards the reform efforts in terms of a comprehensive active-aging strategy as generally positive, but at the same time demands further measures to prevent early retirements (e.g. invalidity pension, public sector). The lack of incentives regard further education of low-qualified workers and immigrants is also criticized.

In 2005, the Lisbon Strategy was thoroughly revised and the goals of stronger and sustainable growth as well as the creation of additional and better jobs became the new focus. From that time on, EES guidelines have been presented in connection with macroeconomic and microeconomic guidelines. The integrated guidelines under EES read as follows:

- Focusing employment policies on achieving full employment, improving quality and productivity at work, and strengthening social and territorial cohesion;
- Promoting a lifecycle approach in employment policy;
- Creating inclusive labor markets, enhancing work attractiveness, and making work pay for jobseekers – including disadvantaged people – and the inactive;
- Improving the matching of labor market needs;
- Promoting flexibility combined with employment security and reducing labor market segmentation, with due regard to the role of the social partners;
- Ensuring employment-friendly labor cost developments and wage-setting mechanisms;
- Expanding and improving investments in human capital; and
- Adapting education and training systems in response to new competence requirements.

Based on the integrated guidelines of the Lisbon Strategy for higher growth and employment, the Member States developed National Reform Programs (NRPs).

I would now like to deal with the evaluation of Austria's National Reform Program (NRP) (Austrian Federal Government, 2005) by the EU Commission (EU Commission 2006). The Austrian Program identifies seven important policy areas: Sustainability of public finance, R&D and innovation, infrastructure, international competitiveness, labor markets, employment, and education and training. In general, the EU Commission regards the Austrian strategy as consistent, while rather short-term oriented. Whereas specific targets are stated for tax ratio (40% of GDP by 2010) and expenditure on R&D (3% of GDP by 2010), there is no specific figure for the employment rate targeted. There is also criticism concerning the missing reference to improving competition intensity in the service sector.

With regard to employment policy, the NRP shows a focus on raising the employment rate, promoting active aging, and reforming education and training activities. Increases in expenditure on active labor market policy, strengthening the

AMS (Public Employment Service Austria), and the measures to reform the apprenticeship system are viewed positively. Criticism is directed at the lack of attention to availability of child-care slots and the integration of migrants in the labor market. Furthermore, the high gender-specific wage differences are pointed out, and there is a call for an adequate balance between flexibility and security regarding the fast development of new forms of employment.

In the area of education and training, the EU Commission commends Austria's good position, but increased efforts to raise the standards in reading, mathematic and sciences are still considered to be necessary.

A final evaluation identifies three strengths and two weaknesses:

- A consistent strategy to promote innovation and environmental technology
- Adequate measures (increase in funds for active labor market policy and decrease in non-wage labor cost) to raise the employment rate;
- Attempts to modernize and promote apprentice training;
- There is a deficit in terms of competitive incentives in the service sector;
- There is a need for additional measures to increase the employment rate of older employees and increased investment in the vocational training of adults.

From my point of view, the state's increased support of research and development must be regarded as positive, but it must be ensured that the financial incentives for the promotion of R&D trigger new activities and are not just taken as windfall profit. Therefore it is necessary to evaluate the promotion measures.

Ex ante the link between higher expenditure on R&D on the one hand and higher growth and thus less unemployment on the other is not granted. From my point of view, efforts to improve the R&D ratio, and thus ultimately strengthen the economy's ability to innovate and to raise its growth potential, are necessary to safeguard Austria's position as a high-wage location. Increased labor productivity should ultimately also lead to more employment. This will only be true, however, if the qualification of the labor force corresponds to the requirements of such new jobs, but at the moment many unemployed lack adequate qualifications.

I am fully in favor of channeling labor market policy expenses to active measures, but such measures need to be evaluated on a continuous basis and adapted if necessary. What is also needed is a more long-term planning horizon for those measures. This is the only way to ensure that the jobless are offered adequate programs to improve their skills and qualifications.

As already mentioned in connection with the OECD's Jobs Strategy, I have some reservations as to whether the current efforts in the field of apprentice training will have positive economic effects in the long term. While tackling youth unemployment is necessary, an international evaluation of active labor market policy measures reveals modest success among youth at best (cf. Grubb and Martin 2001).

In conclusion it can be stated that the OECD's Jobs Strategy and the EU Commission's Lisbon Strategy lead to similar recommendations. The problems of

the labor market are put down mainly to rigidities which impede the adaptation to changing economic conditions<sup>8</sup>. The promotion of an economy's adaptability and innovative power should foster growth and exploit existing employment potentials.

#### 4. Two Factors Influencing Unemployment

Unemployment and its development cannot be interpreted in a monocausal manner. Rather, a number of factors (flexibility of labor and product markets, wage formation process, qualification, education system, design of tax and transfer system, reaction to macroeconomic shocks etc.) interact in their effects on unemployment. In the following, I want to focus on only two factors, i.e. qualification and the cyclical reaction of labor supply to fluctuations in the business cycle.

The risk of unemployment and its development over time cannot be regarded independently of the skill level of the population. Like other countries, Austria also shows a negative interrelation between the risk of unemployment and the level of human capital (see tables 3 and 4). In 2004, 40% of the unemployed had completed only compulsory school education, while 5% had not even reached that level (see table 3). Roughly every third unemployed person has completed apprentice training. About 5% graduated from a vocational school, and roughly 10% of all unemployed had passed their *Matura* (high school diploma qualifying graduates for university-level studies). The share of university graduates among the unemployed is 4%. If unemployment rates are calculated for the individual levels of education<sup>9</sup>, the results are similar. The unemployment risk is significantly higher for less qualified employees. Thus, for example, the unemployment rate among people with no education beyond compulsory schooling is twice as high as the national average<sup>10</sup>. In 2003, the rate for people in this group was 15.6%, while the rate for university graduates stood at only 2.3%. At 6.3%, even the rate for persons who had completed apprentice training was below the national average of 7%.

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<sup>8</sup> For critical remarks see, e.g., Blanchard (2006) or Freeman (2005).

<sup>9</sup> The data provided by the Association of Social Insurance Providers do not allow for a breakdown of employment by level of education. Therefore, the education structure of employment from the labor force survey is applied to the data from the Main Association. However, changes in the labor force survey in 1994 and 2004 led to disruptions in the qualification structure of employment.

<sup>10</sup> The unemployment rates according to the 2004 labor force survey show a very similar picture. According to these statistics, the overall unemployment rate was 4.9%. While the unemployment rate of persons with compulsory education was 9.5%, the rate for persons with completed apprentice training was 4.2%. University graduates find themselves in the most favorable position with a rate of 3%, followed by graduates of vocational schools with 3.7%. The rate for graduates of general-education or vocational high schools was 4.4%.

Table 3: Unemployment by Qualification Level

	2004		2003		Change
	Number	Share of unemployed	Number	Share of unemployed	Development of unemployment (relative)
<i>Unemployed women</i>	103,618	100%	100,362	100%	3.2%
no school education completed	5,329	5.1%	4,946	4.9%	7.8%
compulsory school education	44,346	42.8%	43,020	42.9%	3.1%
apprenticeship	29,075	28.1%	28,622	28.5%	1.6%
vocational school	9,736	9.4%	9,812	9.8%	-0.8%
general-education high school qualifying	3,894	3.8%	3,750	3.7%	3.8%
vocational high school	6,224	6.0%	5,868	5.8%	6.1%
academy of higher education, university	4,540	4.4%	4,006	4.0%	13.3%
<i>Unemployed men</i>	140,262	100%	139,717	100%	0.4%
no school education completed	6,073	4.3%	5,530	4.0%	9.8%
compulsory school education	55,161	39.3%	54,486	39.0%	1.2%
apprenticeship	59,453	42.4%	60,746	43.5%	-2.1%
vocational school	4,463	3.2%	4,374	3.1%	2.0%
general-education high school qualifying	3,640	2.6%	3,566	2.6%	2.1%
vocational high school	6,506	4.6%	6,502	4.7%	0.1%
academy of higher education, university	4,458	3.2%	4,145	3.0%	7.6%

Source: AMS and Association of Social Insurance Providers, compiled by the author.

The available data shows not only a markedly higher unemployment risk for less skilled persons but also a relative deterioration for this group over time. Thus, while the unemployment rate overall has risen by about 0.5% since the mid-1990s, the rate for persons with no more than completed compulsory school education



increased from 11% to 15.5% (see table 4). The increase for this group already accounts for almost the entire rise in the unemployment rate<sup>11</sup>, as the rate had remained more or less constant for all other groups. However, unemployment rose from 3.1% to 3.5% also among high school graduates. Overall, the unemployment data according to level of education suggests that there are significant problems especially in the field of less qualified employees. The job prospects for persons with no more than completed compulsory school education have worsened significantly over the last 10 years.

*Table 4: Unemployment Rate by Level of Education\**

	Overall	Compulsory school	Apprenticeship	Vocational school	High school	University
1990**	5.4%	9.2%	4.5%	3.0%	2.8%	2.2%
1995	6.6%	11.0%	6.5%	3.7%	3.1%	2.2%
1996	7.0%	12.4%	6.7%	4.0%	3.4%	2.5%
1997	7.1%	13.3%	6.6%	4.0%	3.5%	2.4%
1998	7.2%	13.6%	6.7%	4.3%	3.4%	2.3%
1999	6.7%	13.0%	6.2%	4.0%	3.1%	1.9%
2000	5.8%	11.9%	5.5%	3.2%	2.6%	1.6%
2001	6.1%	13.2%	5.6%	3.1%	2.7%	1.7%
2002	6.8%	15.1%	6.2%	3.6%	3.2%	2.2%
2003	7.0%	15.6%	6.3%	3.6%	3.5%	2.3%
2004**	7.1%	17.2%	6.7%	2.8%	3.7%	2.1%

\* *Employed persons according to the Association were classified based on the microcensus information on highest level of education completed.*

\*\* *Disruption in the qualification structure of employed persons 1994 and 2004.*

*Source: Microcensus, Association of Social Insurance Providers, AMS, compiled by the author.*

An international comparison shows that countries with less pronounced cyclical fluctuations in their unemployment rates *ceteris paribus* also have lower levels of unemployment (cf. Elmeskov and Pichelmann, 1994). Several factors influence the

<sup>11</sup> Between 1997 and 2003, the number of registered unemployed increased by 6,730, with the number of unemployed with no more than completed compulsory school education rose by 5,547.

extent of cyclical variability of the unemployment rate over the business cycle. Ultimately, changes in the unemployment rate are the result of the dynamic interaction of the flows into/out of employment, unemployment and non-participation in the labor market. From a purely mechanical point of view, the extent of cyclical fluctuations of output, the reaction of labor demand to output fluctuations and the cyclical variability of labor supply interact in their effects. Finally, also the cyclical reactivity of real wages mitigates fluctuations in production and employment.

Pichelmann et al. (1998) argued that it was especially the high elasticity of labor supply with regards to changes in job prospects, which helped to keep unemployment low in Austria. In the following, indicators for the cyclical response of employment to output fluctuations<sup>12</sup> as well as the reaction of labor supply to fluctuations in employment are estimated for the period from 1988 to 2004.

The reaction of unemployment to cyclical fluctuations in GDP was 0.53 for the period from 1988 to 2004 (see table 5). Thus, changes in the economic situation are not fully reflected in the employment rate, but are also mitigated by pro-cyclical changes in labor productivity. This link cannot be directly equated to the phenomenon of labor hoarding in recession, short-time work and other working time reactions. The relatively high flexibility of real wages and the less business cycle-sensitive employment expansion in the field of private and public services also had a major impact on this cyclical stabilization. Compared to the period from 1970–1996 (0.47), employment reaction increased moderately at best.

In terms of the extent of cyclical labor supply responses in Austria, Pichelmann et al. (1998) reported a value of 0.83, and even 0.93 for the period from 1984 to 1996. As can be seen from table 5, the labor supply response has decreased over time. It was only 0.68 for the period from 1988 to 2004, which is, however, still high by international comparison.

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<sup>12</sup> Simply speaking, these result from a regression of the cyclical component of employment to the cyclical component of output, with the cyclical components each being generated by the HP filter. In the same manner, the cyclical component of labor supply is regressed on employment.

*Table 5: Cyclical Reactivity in the Labor Market*

	<i>Response of employment to fluctuations in output</i>	<i>Response of labor supply to fluctuations in employment</i>
1970–1996	0.47	0.83
1984–1996	0.70	0.93
1988–2004	0.53	0.61
Women	0.62	0.68
Men	0.48	0.55

*Source: Pichelmann et al. (1988) for 1970–1996; Hofer et al. (2005) for 1988–2004.*

The causes for this decline can only be speculated upon. One might argue, for example, that the cyclical character of labor migration has decreased, or that the degree of controllability via administrative measures has decreased significantly. Another possible explanation might be that women are integrated more strongly in the employment system and no longer leave the labor market in unfavorable economic situations. Furthermore, the extension of active labor market policy may have caused people to be less likely to withdraw from the labor market temporarily. Moreover, early retirement has been made more difficult.

## **5. Concluding Considerations and Challenges in the Austrian Labor Market**

Finally, I would like to look at weaknesses in the Austrian employment system and future challenges. As has been shown, a deterioration was noticed especially with respect to less skilled workers. This development is also found in other countries and can be explained by skill-biased technological change or globalization. There is absolutely no indication of a change in this trend in the future. Austria's human capital potential will be central to the further development of its economy. Therefore, I would like to focus especially on the group of low-skilled employees. For this group, it is also necessary to take into account that it will be exposed to increased adaptational pressure in the near future as a result of the expiry of transitional provisions governing the freedom of labor for the new EU Member States. Measures of active labor market policy to improve qualifications are necessary and sensible. However, international evaluations show rather mixed results, in particular in terms of success with respect to youth employment. Coupled with this, Austria also shows clear weaknesses in its system of dual

vocational training. There are significant problems in the labor market integration of people after finishing apprenticeship, and the supply of apprenticeship places falls clearly short of demand. Therefore, measures should be taken at an early stage, i.e. already in the education sector.

A second trend is the aging of society. In order to maintain prosperity and secure financing of the pension system, it will be necessary to raise the labor force participation rate considerably, in particular, but not only, among older employees. Occasionally, it is argued that the (relative) decline in the working population will almost automatically entail a drop in the unemployment rate. This will only be possible, however, if the labor force becomes more flexible. The aging process will bring about changes in the structure of consumer demand. Furthermore, the active aging strategy must be employed at a younger age already. Life-long learning is also necessary to handle the changing demands of the labor market.

## **5.1 Erasing Education Deficits in the School Sector**

One significant goal for the improvement of qualification structures is the pre-emptive support to improve the necessary basic qualifications. This improvement will have effects in the short, medium and long run by reducing academic failure and repetition as well as drop-out rates when vocational qualifications are acquired, and the basic level of competence is improved overall. These measures will also have an impact on PISA results by reducing the share of students with insufficient basic skills.

A more detailed evaluation of the PISA results as well as evaluations of information based on school statistics make it possible to come up with a rough definition of the scope of the target group for such support measures. According to the 2003 PISA study, in the areas of mathematics and reading, 19% and 20%, respectively, of all students – that is about 19,000 youth per year, or about 171,000 children and youth, if extrapolated to the entire compulsory school population – fall into that risk group which reaches only competence level 1. This group is exposed to a great risk that the lack of fundamental knowledge and skills may impede their future participation in business and social life. In particular, students with a migrant background or a disadvantaged social background produce significantly worse results.

A promising instrument can be found in the form of individualized promotion of specially qualified persons or services working on remedying specific problems, such as measures for German as a second language as well as various forms of consulting, accompanying or supporting teaching staff. Some of these support measures could be offered by external services.

It was not possible to further reduce the share of youth who drop out of school early, and is now – according to the European key indicator based on a labor force survey – at roughly 9% (EU average: 17%) for 18 to 24-year-olds. Thus, about

8,900 youth per year leave the education system at secondary level II without any diploma, resulting in a total number of about 60,000 people if extrapolated to the entire age group.

## **5.2 Improvement of Continuing Education and Life-Long Learning**

In an international context, there is a rather low level of organizational activities in continuing education, and SMEs – due to a number of factors – are less active in this field than larger companies. In addition to tax incentives, the European Social Fund (ESF) promotes measures aiming at improving the qualification of employees directed at the target groups of labor market policy (low-skilled or older employees, women), e.g. by means of financial support for participation in qualification measures. Older and less qualified employees, as well as small (less than 100 employees) and very small (less than 10) enterprises are underrepresented.

Synthesized results of the impact of further education and training show that such measures rather tend to lead less qualified and older employees to stay with the company for longer. At the same time, there are certain factors working against the employment of older people, in particular the gap between income development and productivity.

Strategies to promote life-long learning are required, even though success has been limited so far. Activities in further education and training tend to be concentrated on more highly qualified employees also on an international level. Thus, low-skilled employees must be offered additional incentives to increase their human capital and improve their skills and education level on a continuous basis.

## **5.3 Job Incentives for Women**

Against the backdrop of an aging society, it is necessary to exploit the labor force potential; in particular, it would be possible to increase the employment rate among women. What is required here is an improved work-life balance. Women are faced with problems when reentering the professional life which get more pronounced the longer they had been absent from the labor market. Child care commitments represent a major obstacle to mobility in the labor market. For this reason, it would appear necessary that the state should contribute more generously to financing child care services for working mothers. It would be necessary to improve the coordination of working hours with operating hours of child care facilities. Also, the regulation of maternal leave times has a rather significant impact on the labor supply of mothers (cf., for example, Lalive and Zweimüller 2005). Thus, if the employment rate of women is to be increased, reforms concerning child care benefits (e.g. reducing the period of entitlement) are well worth considering.

What should also be subjected to a critical review in this context are the high gender-specific wage differences. However, measures to reduce these gaps always have to take into account the underlying reasons. To the extent such gaps are due to differences in productivity, a reduction would affect the employment chances of women negatively. Wage differences that are based on discrimination (cf., for example, Böheim et al. 2005) reduce the efficiency of the labor market and need to be removed.

## **5.4 Unemployment Insurance and the Integration of the Tax/Transfer System**

By international comparison, the Austrian unemployment insurance system is not particularly generous. Therefore, a reduction of the net replacement rate is not recommended. Attempts to activate labor market policy in recent years have to be viewed as positive efforts. A successful labor market policy should aim at providing financial security to unemployed persons. In return, however, it is necessary to require a willingness in terms of taking part in further education and training, increasing search efforts and taking up employment. Against this backdrop, innovative labor market policy measures such as “*Kombilohn*” wages subsidized by the state) are certainly worth considering.

Frictional and/or seasonal unemployment are highly relevant in Austria, both in an international comparison and in terms of their relative share in overall unemployment. Roughly one fifth of total unemployment is accounted for by this component. The introduction of an experience-based element in the unemployment insurance system might thus lead to a reduction in unemployment which takes effect fast and is sustainable.

The current system of social welfare must be regarded with caution. As some provinces still force employees to repay benefits, there are incentives to withdraw from the labor market permanently. Thus, a closer integration of “*Notstandshilfe*” (assistance for persons no longer eligible for unemployment benefits) and social welfare should be considered.

## **5.5 Reduction of Non-Wage Labor Cost Especially in the Low-Wage Sector**

Numerous studies prove the negative impact of labor taxes (tax wedge) on the development of the labor market. For this reason, it seems sensible and necessary to further relieve non-wage labor cost for labor market policy reasons. High marginal tax rates keep people from taking up employment, which is especially true for low-skilled employees. Thus, a reduction of social security contributions is worth considering for that group.

## 5.6 Wage Formation Process

By international comparison, the macroeconomic real wage flexibility is still high. In their wage negotiations, the social partners focus on macroeconomic goals, which helps keep unemployment low. However, the rigidity of relative wage structures (education, industry, gender) and low wage mobility must be reviewed. Furthermore, a company's specific situation should be taken into closer consideration in wage formation, e.g. by making use of opening clauses in bargaining agreements. The introduction of minimum wages which has been discussed for a while, however, should be regarded with caution, as distribution goals can be reached in a better way by means of the tax and transfer system.

## 5.7 Strategies for Active Aging

I consider the reform steps taken in the field of pension insurance positive, but there are still problems in employing older people. A reform of invalidity pensions is due. However, the promotion of life-long learning and the increased participation in continuing education measures are not the only factors necessary to increase the labor-force participation rate of older employees; it is necessary to take measures already at an earlier stage. Possibilities include, for example, incentives for employers to reduce the probability of industrial injuries as well as occupational diseases. Measures for active aging (e.g. reduced shift work, early retraining following heavy labor, health prevention) are required.

## 5.8 Making Working Hours More Flexible

Globalization and strong competitive pressure require increasing flexibility from both, companies and employees. Here, the main problem will be the design of intelligent working time models which fulfill operational requirements on the one hand and do not put employees at a disadvantage on the other hand, either.

The increase in part-time work must be viewed as positive in this context. However, it must be ensured that part-time workers are not excluded from corporate training and education measures.

## 5.9 Eastern Enlargement and Freedom of Labor

The EU's eastern enlargement will put even more pressure on less skilled employees. This would appear to make it necessary to increase efforts to improve the skills of less qualified Austrian employees or foreign employees already resident in Austria. The experience of the early 1990s has shown that the Austrian labor market is not in a position to fully absorb labor supply shocks. Therefore, transitional provisions do make sense, but it would be necessary already at this

point to loosen restrictions or gradually open the labor market, for example by defining quotas, in order to avoid a massive labor supply shock when the transitional provisions expire.

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