



# Policy Brief on The institutional evolution of labour market institutions in Europe and entrepreneurship

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# Policy brief on The institutional evolution of labour market institutions in Europe and entrepreneurship

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## Abstract

Labour mobility is an important condition for entrepreneurship. Present policies call for deregulation of the labour market institutions as the preferred mechanism to stimulate entrepreneurship. However, in Deliverable 2.5 we argue that an a-historical one-size-fits-all approach is likely to be misguided in the much more diverse European setting compared to a country like the United States.

## Introduction:

What is the impact of labour market institutions on entrepreneurial activity? Recently it has been argued that flexible labour market institutions have a positive influence on entrepreneurial activity. No doubt, labour mobility is an important condition for entrepreneurship. The institutions governing the allocation of labour and talent in society enable entrepreneurs to develop their businesses and affect the willingness of employees to be(come) entrepreneurial. In Deliverable 2.5 we analyse these institutions by reviewing labour market regulation in European countries from a historical perspective.

We focus on three pillars: regulation of labour markets, wage-setting institutions and social insurance systems.

The European Commission (2013) stresses the importance of modernizing labour markets (simplifying employment legislation and developing flexible working arrangements) and of stimulating an entrepreneurial culture in Europe. However, we would like to highlight that this perspective is likely to be overly simplistic. First, one-size-fits-all reform strategies are unlikely to be successful due to institutional differences and because of country-specific institutional complementarities. Second, some (informal) institutions, notably deep-seated cultural characteristics, are difficult to change due to their historically devel-





oped embeddedness.

The findings of Deliverable 2.5 (Dilli 2016) calls for a more nuanced perspective on one-size-fits-all policies. These policies call for deregulation of the labour market institutions as the preferred mechanism to stimulate entrepreneurship. While this is likely to be the most appropriate policy prescription in the case of Anglo-Saxon liberal economies, the analyses in Dilli (2016) and Dilli and Elert (2016) shows that a general deregulation of labour markets is unlikely to be the best way to stimulate entrepreneurship in all identified clusters of countries. Therefore, there is need for alternative policy measures and strategies, which take into account each country's complementarities and the idiosyncrasies of the institutional structures.

## Methodology

The *Varieties of Capitalism* framework is used (Hall and Soskice 2001) to take into account the interdependencies between the labour market institutions, and to evaluate to what extent changes in one set of labour market institutions influence the national policies in general. In liberal market economies (LMEs) individual firms and employees negotiate pay rates, whereas in coordinated market economies (CMEs) national trade unions and employers' associations bargain over wages, which then apply to specific collectives of workers.

Deliverable 2.5 analyses whether the varieties in labour market institutions have converged over time as a result of processes such as deepened integration among EU countries, globalization, and financial and product market deregulation. Cluster analysis is used to get an overview of the evolution and possible convergence of the varieties of labour market institutions over time.

A further goal of Deliverable 2.5 is to evaluate the implications of the cross-country variations in labour market institutions for the entrepreneurial activity in Europe. The results of the cluster analysis are used to create a dynamic grouping of the countries over time, which helps to explain the variation in entrepreneurial activity in Europe. The empirical evidence is obtained by employing regression analysis.

## Results and Conclusions

All European Union member countries have some form of social security system, wage-setting institutions and employment protection legislation. Deliverable 2.5 highlights that a number of labour institutions have changed considerably since the 1980s due to explicit deregulation and spontaneous evolution. However, these changes have not resulted in complete convergence towards a liberal market economy (LME) system over time. In fact, the results of the cluster analysis reveal six distinct bundles, or types, of labour market institutions. Evidently, labour institutions can follow different evolutionary paths. The historical perspective also makes it possible to recognize that some countries have experienced a transition from one cluster to another since the 1980s.

In line with the *Varieties of Capitalism* literature (Hall and Thelen 2009) in Deliverable 2.5 we explain these persistent differences by the presence of institutions that have developed historically and in close interaction. Therefore, our analysis does not support a one-size-fits-all reform package for the member countries as a means to make the EU more entrepreneurial. Another important reason why the EU should avoid one-size-fits-all policies is the importance of complementarities between labour market institutions. This means that the co-existence of two or more institutions matters for their performance. They mutually





enhance the performance contribution of each individual institution, making the whole more than the sum of its parts (Schmidt and Spindler 2002). In other words, institutional arrangements have evolved historically into complex, interrelated and multi-layered systems of complementary arrangements.

In summary, research in Deliverable 2.5 suggests that the link between labour market institutions and entrepreneurial activity depends on the complementarities in labour market institutions over time. For instance, the negative link between centralized wage-setting institutions and the business ownership rate is only visible in Anglo-Saxon countries, whereas social security arrangements in Eastern Europe correlate positively with higher business ownership rates. Overall, the findings highlight the importance of taking into account these complementarities while searching for adequate policy tools to promote an entrepreneurial society in Europe.

Figure 1 shows the clustering of 19 European countries and the United States into six different institutional families and their changes over time. We recommend that entrepreneurship policies concerning labour market institutions be made complementary to a country's institutional environment in order to be effective.

## Implications and Recommendations

Varieties of capitalism leads to varieties in entrepreneurship. Therefore implementing policies in Europe that have been demonstrated to successfully support entrepreneurship in the United States and/or are focused solely on deregulation in order to move the national institutional setup as close as possible to the archetypical liberal market economy, is unwise. In other words, in Deliverable 2.5 we argue that an a-historical one-size-fits-all approach is likely to be misguided in the much more diverse European setting compared to a country like the United States. As a matter of fact, changes in a certain element in the direction of the LME model give rise to inconsistencies, which could make the model less efficient.





**Table 1**

Results of the cluster analysis and the 6 grouping of countries over time

	(1) 1972– 1979	(2) 1980– 1998	(3) 1990– 1999	(4) 2000– 2010
Austria	1	1	2	2
Belgium	2	4	3	2
Czech Republ.	5	5	5	5
Denmark	1	1	2	1
Finland	1	1	1	1
France	3	3	4	4
Germany	4	2	2	3
Greece	3	4	5	4
Ireland	2	6	6	4
Italy	4	4	3	3
Netherlands	2	2	2	2
Norway	1	1	1	1
Poland	5	5	5	5
Portugal	5	4	4	4
Slovakia	5	5	5	4
Spain	4	3	4	4
Sweden	1	1	1	1
Switzerland	2	2	2	1
United King- dom	2	6	6	6
United States	6	6	6	6

## Sources and further reading

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