

Shaping Earnings Volatility: Labour Market Policy and Institutional Factors

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Abstract:

This paper explores the role of labour market policy and institutional factors in explaining cross-national differences in earnings volatility in Europe between early 1990s and 2001. Using non-linear least squares we reveal a complex framework, where institutions and their systemic interactions play a decisive role in shaping earnings volatility and in altering the adverse effect of macroeconomic shocks. Whereas "piece-meal" reforms appear more effective in reducing earnings volatility than comprehensive policy packages, some complementarity effects do emerge. *Ceteris paribus*, labour market regulation, deunionization, the transition from a decentralized to a corporatist economy, decreasing tax wedge, product market deregulation, decreasing active labour market policies, and increasing generosity of the unemployment benefit emerge as reforms negatively associated with earnings volatility. The effect of each reform, however, depends greatly on the institutional mix. High corporatism emerges as the most effective tool in counteracting the adverse effects of macroeconomic shocks on earnings volatility. Additionally, we bring evidence of an institutional mechanism that triggers a potential trade-off between labour market rigidity and earnings volatility.