

**The Unemployment Benefit System and Wage Flexibility in EMU:
Time-varying Evidence in five Countries**

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A large number of European countries still cope with historically high unemployment rates. One line of research that has been followed to explain European unemployment and the differences among European countries is the impact of labour market institutions. One important channel through which labour market institutions may affect unemployment is the responsiveness of wages to unemployment, commonly referred to as (real) wage flexibility. It has been shown that cross-country differences in labour market institutions can account for differences in wage flexibility, but there is no coherent econometric work that explores the relationship between *changes* in labour market institutions and wage flexibility over time *within* countries. This is the issue addressed in this paper. Wage flexibility is defined as the coefficient on unemployment in a 'bargaining-augmented' wage equation, explaining (real) wage growth. We investigate the role of unemployment benefits in determining the degree of (real) wage flexibility. To this end we estimated a wage equation in a time-varying parameter framework for five core EMU countries. In Italy the unemployment benefit system is very limited. For the four other countries, the results show that, except for Belgium, wage flexibility is not related in a significant way to the generosity of the unemployment benefit system. This insight runs counter to the conclusions offered by cross-section studies. We therefore tentatively conclude that we should not be too optimistic about the effect of reform of the unemployment benefit system on wage flexibility and that such reform –in order to be really effective– should be radical.