The labour market in the euro area

Stage Three of European economic and monetary union began on January 1, 1999. For 11 EU member states, this meant that the establishment of the single market for goods and services was followed by the transition to a single monetary and foreign-exchange policy. By contrast, the labour market in the euro area is still extremely fragmented, with countries having a stubbornly high unemployment rate in the same currency area as countries having an employment situation that is enduringly more favourable. On the whole, the labour market situation has deteriorated even further in the nineties. At present, around one person in ten in the euro area labour force is out of work.

In the long term, an important key to ensuring the acceptance and success of economic and monetary union will be, if not to completely solve, then at least to substantially reduce the dogged unemployment problem in stages, particularly in the major euro area member states. Moreover, well-functioning labour markets make it easier for the European Central Bank to perform its tasks. Therefore, in future it will be more crucial than ever that those euro area countries with less successful labour market policies do not fall too far behind. In this situation, bearing in mind each country's starting position and individual problems, a certain orientation towards countries with flexible labour markets and high employment may be helpful.

Basic trends in the nineties

Extent of unemployment ...

The situation in Europe's labour markets is in many cases characterised by high and stubborn unemployment. In mid-1999, according to Eurostat figures, some 13 million people were out of work in the eleven euro area countries. In terms of the total labour force, this corresponds to a rate of just over 10 %. This average figure, though, conceals a sharp divide in the national unemployment rates. Whereas in a number of smaller countries such as Luxembourg, the Netherlands, Austria and Portugal less than 5 % of the labour force was without (regular) work, this figure amounted to over 10 % in France and Italy and almost 15 % in Spain. There are striking discrepancies even within countries. For example, the unemployment rate in southern Italy is over 20 %, whereas in the northern part of the country less than 5 % of the labour force is out of work. Similar regional disparities are also visible in Spain and Germany.[1]

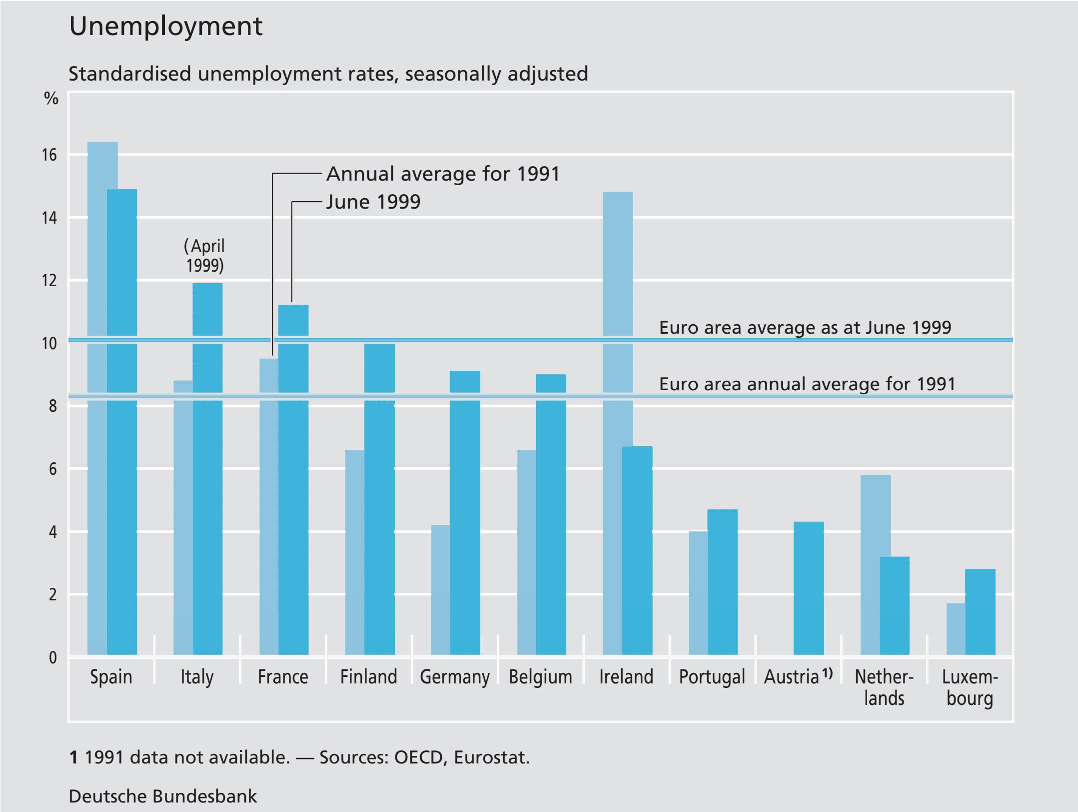
... and lines of development

A comparison of current information with 1991 figures[2] shows that for those countries which have formed part of the single European currency area since the beginning of 1999, the total number of unemployed persons has risen by over 2½ million, and the unemployment rate by almost two percentage points. The individual trends, though, are vastly different. A select few countries have managed to largely maintain the favourable situation they had had from the beginning. This is particularly true of Luxembourg, Austria and Portugal. In those countries, the number of unemployed persons did rise somewhat, but the unemployment rate has remained below 5 %. Two countries have achieved a sustainable improvement: in the Netherlands, it was possible to reduce unemployment once more from 6 % to slightly more than 3 %, and in Ireland, the rate plummeted from almost 15 % to less than 7 %. In other countries, clouds set in over the labour market. This happened in the major economies of Germany, Italy and France, thus affecting the overall picture in the new currency area. Spain is a special case: at one point well over 20 % of the labour force was out of work before the unfavourable trend reversed itself. The total unemployment rate in the euro area countries increased up until 1994 and remained at that high plateau for quite a long time; only since 1998 has the situation eased somewhat.

Weak convergence of labour markets

The tendency for unfavourable labour market situations to become entrenched and the consolidation of employment success are the reasons why no major change has occurred in the spread of national unemployment rates since the early nineties. If the range of the rates is taken as a yardstick, the differences – excluding Luxembourg – have recently been about as great as they were at the beginning of this decade. The weighted standard deviation, by contrast, has declined somewhat,

1 On the significance of regional disparities, which will not be discussed any further in this article, see: Mauro, P., Prasad, E. and Spilimbergo, A. (eds.) (1999), Perspectives on Regional Unemployment in Europe, IMF Occasional Paper 177, Washington DC.
2 1991 was chosen as a reference year because it is the first year for which data are available for a united Germany. The negative trend for Germany (and the overall euro area) is overstated because the formerly hidden unemployment in eastern Germany was revealed in the following years.



because the major countries are now clustered more closely around the – increased – average.

Low level of migration

Migration of labour has made no meaningful contribution to closing the labour market gaps in monetary union. One reason for this is undoubtedly the fact that wages and salaries in the countries with labour market problems are often higher than in those countries with more favourable labour market developments. Put differently, the price signals are pointing in a different direction from the quantity signals. Furthermore, other factors such as linguistic and cultural barriers, as well as differences in social security systems, stand in the way of offsetting flows of migration. Moreover, experience has shown that – even within the euro area countries – major disparities in income and employment opportunities are needed in order to trigger migratory flows. Consequently, as expected there have been hardly any major labour market-induced movements of EU citizens within the EU in the recent past.

In most of the nine countries for which the relevant information is available, the share of total immigration accounted for by EU citizens was of late no more than 10 % to 20 %. The only exceptions were Luxembourg and Belgium, where EU immigration made up nearly three-quarters and almost half of total immigration, respectively. This may be closely linked with the fact that major European organisations are based in both countries. That also has an impact on the share of foreigners from EU countries in the total resident population. Although this rate in Belgium, at just over 5 %, was only one-sixth that of the figure for Luxembourg, it was still much higher than average compared with the other European Union countries. In the Union as a whole, the percentage of EU citizens living in another member state amounts to less than 2 %. The minor significance of migration within the EU is highlighted also by the fact that the share of the resident population taken up by all foreigners was more than double that of EU foreigners. Accordingly, in the foreseeable future it is not likely, under these circumstances, that migration within the euro area will make a noticeable contribution to cushioning regional shocks.

Structure of unemployment

Unemployment at the beginning of one's career ...

The risk of not finding a job and being unemployed at least temporarily is particularly pronounced among employees between the ages of 15 and 24. At around one-quarter, their share of all registered unemployed persons within the territory of the European monetary union is twice as high as their weight within the total labour force. Particularly the search for the first job is often fraught with difficulty. Nearly half of all unemployed youths are confronted with this problem. Another one-third have held a job but left it voluntarily or involuntarily after a rather brief period – prior to the age of 24. The situation is exceptionally difficult in Finland, France, Italy and Spain. In 1997, nearly 30 % of the young job-seekers in France were unemployed; this figure was around one-third in the other three countries. On the other end of the scale are, by a wide margin, Germany, Luxembourg, Austria and the Netherlands. The specific unemployment rates for this age group are only slightly above or in some cases even significantly lower than 10 % in those countries. The main factor is probably the vocational training systems in Germany, Luxembourg and Austria, which, despite all their differences, still share four features: vocational training and gradual integration into the working process in private-sector enterprises (or public-sector bodies), relatively low remuneration, strictly limited-term and purpose-oriented training contracts, and further education at vocational schools. In the Netherlands, too, in-house vocational training plays a crucial role. Although in many of the countries affected by high youth unemployment persons entering the labour force earn reduced minimum wages, often these low entry-level wages do not match the level of productivity, which is still lower.

... and at the end

A second set of problems is posed by older employees, which in this context refers to those over the age of 50. As an average of the entire euro area, over 15 % of all unemployed persons fall into this age group. For Germany, this share is twice as high, putting Germany far ahead of every other country. Countries just below the EU average are Austria, Finland and Portugal. Apart from Luxembourg, the lower end of the scale is occupied by Italy, where the percentage of unemployed persons in this age group is only one-fifth that in Germany. This is not least a consequence of the Italian statutory system of old-age provision, where persons can retire relatively early without major deductions from

Definitions and sources of international labour market statistics

In the public discussion on the labour market situation, reference is generally made to the number of unemployed persons registered at the national labour authorities. Such information is often only partly suited to international comparisons since the conditions for entitlement to unemployment benefits and the level and duration of their payment vary considerably among countries. However, transfer payments are an important incentive to register at the labour offices.

Therefore, for years the OECD has been maintaining a database of labour market data collected from surveys. They are based on a set of definitions adopted in 1982 by the ILO and the OECD. The most important of these definitions are as follows:

1. Labour force: All persons who fulfil the requirements for inclusion among the employed or the unemployed.

2. Employed: The employed include all persons above a specified age who during a specified brief period (one week or one day) either had paid employment or were self-employed. These include those paid employees and self-employed persons who were temporarily not at work owing to illness or vacation, for example.

3. Unemployed: The unemployed comprise all persons above a specified age who during the reference period either were not in paid employment or self-employment but who were seeking work and were currently available for work.

More detailed definitions can be found in: OECD (1999), Statistics Directorate: Labour Force Statistics 1977–1997, Paris.

All the same, the information published by the OECD based on these definitions is, strictly speaking, not yet completely comparable because methods of collecting data differ from one country to another. However, these data are much more comparable than information based on purely national definitions. Stricter comparability criteria are met by the standardised unemployment rates, which are also published by the OECD and, for EU member states, are calculated by the Statistical Office of the European Communities (Eurostat). These calculations are based on regular surveys. See: Eurostat (1998), European Labour Force Survey, 1997 Results, Luxembourg.

One source of information for this article is the OECD Labour Force Statistics. Those data are only complete up to 1997. Other information has been taken from Eurostat's 1997 European Labour Force Survey, the Eurostat demographic statistics (as of 1996) and Eurostat's ongoing reporting.

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their pensions.[3] Therefore older employees in Italy who lose their jobs typically collect pension payments and are thus no longer registered as part of the labour force. In Germany, however, they receive unemployment benefits and, in surveys, often classify themselves as still seeking work. In 1997 an average of only just over 55 % of the men (female employment is visibly characterised by the different cultural traditions) between 50 and 64 in the euro area were still employed. Both Italy and Germany, occupying the extreme positions in terms of unemployment in this age group, did not stray very far from the average. The lowest figures were recorded in Belgium, whereas in Ireland and Portugal, over 65 % of the men between 50 and 64 were still working.

Long-term unemployment

Many of the older persons, however, are probably in that segment of people who at the reporting date of the survey had already been unemployed for a year and longer. As a euro area average, half of all registered unemployed people had been without work for 12 months and longer. This corresponds to nearly 6 % of the total labour force. For nearly two-thirds of them – or well over four million people – this period of unemployment has lasted even longer than 24 months. The prospect of finding a job without assistance is surely not very bright for many of those people, since experience has shown that over longer periods of unemployment, important skills or motivations for working wither away. The countries particularly affected by above-average long-term unemployment were Italy and Spain, where over 8 % and 10 % of the labour force, respectively, had been out of work for at least twelve months. By contrast, in France, a country with an above-average level of total unemployment, the rate of long-term unemployment, at 5 %, was below the euro area average. This is also attributable to the fact that although in France first-time employees often do not find long-term jobs at the beginning of their careers, the periods of unemployment are often interrupted either by short-term employment or training measures.

Labour force potential and employment

Trends in participation in the labour force

Unemployment rates alone are an insufficient indicator of labour market developments owing to different national regulations both at the beginning and the end of one’s career, different systems of disability pensions, different types of unemployment insurance and disparate trends in female employment. It is possible, for example, to “buy” low unemployment rates at the cost of a sub-par participation rate. Movements in unemployment rates should therefore always be seen in connection with other indicators, especially changes in the propensity to seek work.

In terms of the working-age population, which is confined to an international standard range of between 15 and 64 years, participation in the labour force in the overall euro area has remained virtually unchanged since the beginning of the nineties. At some

3 See, for example: Blöndal, S. and Scarpetta, S. (1997), Early Retirement in OECD Countries: The Role of Social Security Systems, OECD Economic Studies 29, pages 7 to 54.

two-thirds, the activity rate was noticeably lower than, for instance, in the United States. Some countries, though, stray considerably from the euro area average. In three countries with unfavourable labour markets, i.e. Finland, Germany and Italy, a downward trend in the participation in the labour force can be observed, whereas in all of the countries with more successful labour market policies a distinct rise in the participation rate is visible. The Netherlands, for instance, have seen a rise in the participation rate by five percentage points to nearly 73 %. In Austria, Ireland and Luxembourg, too, the tendency to participate in the labour force has risen sharply. A rise in the propensity to seek work therefore does not necessarily lead to a shortage of jobs, and a decrease in the supply of labour – often politically motivated – does not automatically reduce unemployment.

Participation in the labour force * in 1997

* Employed plus unemployed as a percentage of the population between the ages of 15 and 64. — Source: OECD Labour Force Statistics.

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Rising propensity of women to enter the labour force ...

The declining number of older persons in the labour force – owing to early retirement – and of younger persons – owing to longer periods of schooling and training – has in many cases been offset by the increasing female participation in the labour force, which has gone up sharply in nearly all euro area countries, the greatest gains being achieved in countries where female employment has traditionally been very low. Increases of over 5 % were recorded in Austria, Luxembourg, the Netherlands and Spain; in Ireland, this figure rose, from a level of 40 %, by over 10 %.

... and an increase in part-time work

This is also closely linked to the increasing significance of part-time work. In 1997, according to Eurostat's European Labour Force Survey, there were some 17 million part-time employees. The Netherlands were by far the top country in this category; nearly two-fifths of all employees – including many men – belonged to this group. At the other end of the scale are the three southernmost countries in the euro area, where less than one-tenth of employees worked reduced hours. Whereas in Italy and Spain this is linked to the continued low rate of female employment, in Portugal high employment among women and a low rate of part-time employment exist side by side.

Overall developments in employment ...

During the period under observation the labour force, measured here in terms of the working-age population, has increased in all euro area countries. This has presented an additional challenge to the ability of labour markets to absorb these job-seekers, also in the light of the already existing levels of unemployment. The euro area countries have met this challenge in a variety of ways. On average, employment in the countries in monetary union went down slightly during the period under review. Important factors behind this decrease were sharp job losses in Germany and Italy. In other countries, employment has risen continuously. The most successful country was Ireland, where the number of jobs has gone up by an annual average of roughly 3 ½ % between 1991 and 1997, and thus distinctly faster than the working-age population (+ 1½ %), and also the labour force (+ 2 ½ %) during this period. Similar, if less pronounced tendencies, have been noticed in Luxembourg, the Netherlands and Austria.

... and structural changes

Under the circumstances, the expansion of employment opportunities has been made more difficult in some regions of the currency area by rapid structural change which has in some cases led to the large-scale elimination of jobs in manufacturing. Between 1991 and 1997 a total of over four million jobs were lost. Only Ireland was able to register growth here. Downsizing continued in the agricultural sector, too, yet in most countries it did not play a major role owing to agriculture's already low share in overall employment.

The main factor in the varying performance of the labour markets was thus the ability to create opportunities for the increased labour force to find work in the services sector. There, though, it is not just new lines of business that have been created. Rather, industrial enterprises have spun off whole areas, which have then become units considered to be in the tertiary sector. Over the past few years, far more than half of all euro area employees (more precisely, well over 60 %) have been employed in the services sector. At the beginning of the nineties, this figure had been nearly five percentage points lower. Employment in the services sector grew the fastest in Ireland, followed by Luxembourg, Austria, the Netherlands and Portugal. Spain, too, saw relatively strong growth, whereas the dynamic was much more subdued in the other countries. Services were most important in the Benelux countries of late, whereas in Germany employment in industry was still higher than average. Portugal was the only country where more than 10 % of employees were still working in the primary sector, accounted for largely by agriculture.

Strategies of countries with successful employment policies

Countries having a successful employment policy

When comparing labour market situations, one will find that time and again some countries stand out by having an unemployment rate that is half the euro area average (or even lower). Two of these countries are Austria and the Netherlands. Another frequently mentioned case is Ireland, where unemployment, although still comparatively high, was slashed considerably. Owing to the unsatisfactory labour market situation in other countries, the question is often raised as to whether the successful countries can somehow serve as an example for others to follow.

Therefore, it seems appropriate to discuss their labour markets in more detail.[4]

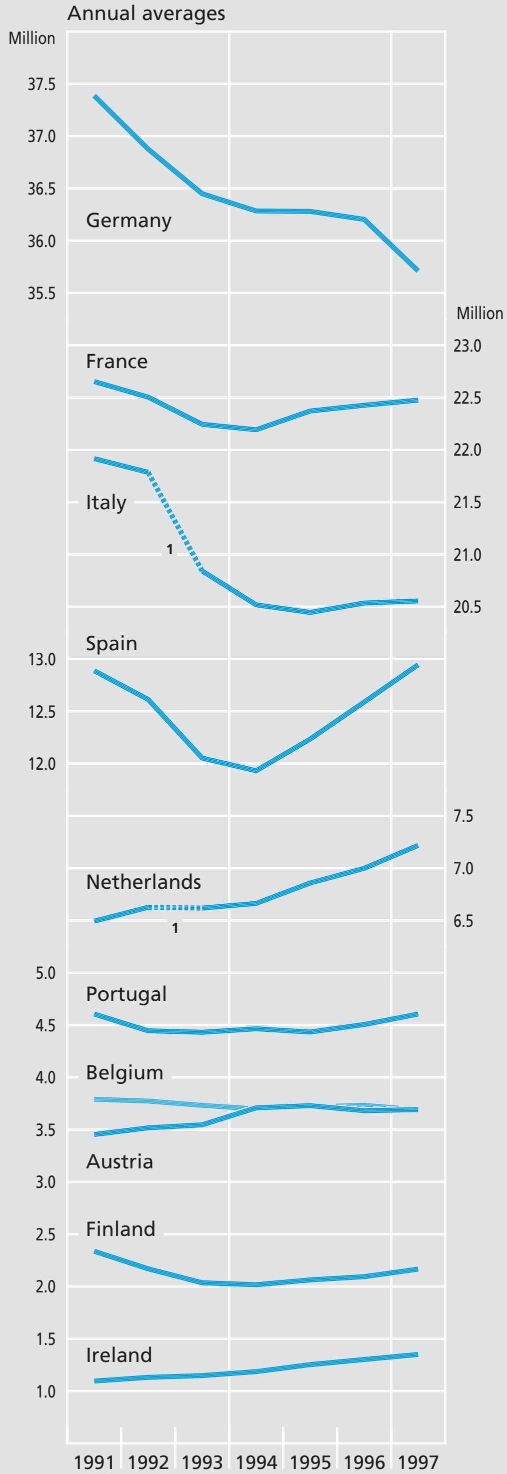
Austria

Austria, at barely over 4 %, had the lowest unemployment rate (apart from Luxembourg) in the entire euro area up to and including the second half of the nineties. Even though the unemployment rate has been rising almost constantly over the past few years, tending to cast shadows over the situation, all labour market indicators continue to point to an above-average performance. One important factor in this favourable situation is certainly the social partnership-oriented employment and wage policy, which in this form is only likely to succeed in a relatively small country with a long tradition of consensus politics. The wage agreements of the social partners generally follow the pattern of those in the metal industry, but also take sectoral factors into consideration. For its part, the metal industry adopts a macro approach to wage bargaining, especially basing its demands on overall productivity growth (and not just on the metal industry's – higher – productivity growth). Through these macro elements of wage bargaining, a large degree of elasticity between real wages and unemployment could be achieved. An explicit low-wage policy was avoided; at the same time, on balance, a distinct wage dispersion is visible. In addition, the period for claiming unemployment benefits is kept short, and the

4 The countries in this article are covered in greater depth in other publications such as the following: Fajertag, G. and Pochet, P. (eds.) (1997), Social Pacts in Europe, Brussels; Ferner, A. and Hyman, R. (eds.) (1998), Changing Industrial Relations in Europe, Oxford; Dohse, D. and Krieger-Boden, C. (1998), *Währungsunion und Arbeitsmarkt, Auftakt zu unabdingbaren Reformen,* Kieler Studien 290, Tübingen.

Employed

Annual averages



1 Not fully comparable. — Source: OECD Labour Force Statistics.

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conditions for subsequently receiving emergency assistance are quite strict. This explains, for one thing, the small percentage of long-term unemployed persons in Austria. Another point is that movements into and out of the "hidden reserve" are supported. For individual groups of persons, these movements are cushioned, for example for older persons through early retirement and for women through unpaid leave regulations, family assistance and child benefit payments. Finally, the employment situation is supported by a large public-sector share. By combining all these elements, it was possible to keep the number of registered unemployed low for a long time. However, there are more and more signs now that this "policy mix" is losing its effectiveness.

The Netherlands

This may be one reason why the Netherlands are attracting more and more attention. As early as the beginning of the eighties, when unemployment had risen drastically, the social partners, under the aegis of the government, reached an agreement on wage moderation and reduced working hours. At the same time, decentralised bargaining was restored, which meant that, as in Austria, the macro component of general wage moderation could be combined with a sophisticated method of making adjustments for sectoral characteristics. In addition, the legal minimum wage was lowered somewhat, in relative terms. Admittedly, unemployment initially only went down at a snail's pace, placing an increasing strain on the welfare net. The government therefore saw the need to introduce drastic cuts in the social sector, particularly in unemployment insurance and disability pensions. These measures were directed at halting the downward trend of participation in the labour force, with further training or retraining schemes playing a major role. Instead of further general reductions in working hours, the opportunities to enter into flexible employment contracts were greatly expanded. Temporary placement agencies emerged, and existing tax and social policy obstacles to the creation of part-time jobs were eliminated. New part-time employment opportunities were created, especially in the services sector; they were seized by many job-seekers, even many men. Acceptance of such forms of employment is likely to be great in the Netherlands and also much greater than in most other European countries. Up to now, at least, it is to be considered a specifically Dutch phenomenon and explains, along with the existing economic structure, the relatively low employment threshold of this economy.

Ireland

Compared with Austria and the Netherlands, Ireland presents a special case. The employment situation hinges on an extraordinarily strong growth of overall economic output, which has enabled Ireland to catch up with its European partners in economic performance following its accession to the EU. From the early nineties up to the end of the decade, real GDP growth averaged around 7% per year, compared, for example, with roughly 3% in the Netherlands. Low tax rates for companies willing to move to Ireland also contributed to this growth; the extension of the required infrastructure was financed in no small part from EU funds. It is true that this helped increase labour productivity by a wide margin; yet the number of employees also rose by over one-fifth. In this strong wake, unemployment has plummeted; the unemployment rate, which reached some 15 % at the beginning of the nineties, has fallen by around eight percentage points. Despite strong growth and the rapid reduction in unemployment, wage rises have successfully been held within stability-oriented limits. Wage policy has mostly been oriented towards the overarching objective of increasing and maintaining the Irish economy's international competitiveness. Although wage increases have been negotiated at a largely local level, they are geared towards the wage guidelines agreed between important groups of society since the end of the eighties.

Similarities and special features

The examples chosen here indicate that in each case a different set of economic, social and labour market policies, designed for each particular situation, was implemented. Here, corporatist elements were of major importance. In all three countries, it was possible to come to a general consensus at least some of the time, especially regarding a basic orientation of wage policy to macroeconomic exigencies but also concerning flexible adjustment to sectoral requirements. The important prerequisite for such a consensus-based strategy was that the above-mentioned countries are relatively small, homogeneous economies. The same holds for Portugal and Luxembourg, incidentally. In the larger, less homogeneous economies, such social pacts are immensely more difficult to negotiate and to implement.[5] In addition, the first steps towards reform were implemented in Ireland and the Netherlands as early as the eighties, and those policies were steadfastly adhered to despite an arduous lean period. In addition, the fact that Austria and the Netherlands strictly abided by the German monetary policy probably promoted wage moderation that was conducive to job creation.

A look at the United States ...

The euro area countries must not only compare their labour market developments with one another; a look beyond the frontiers of monetary union may reveal other perspectives. For example, since 1991 employment in the United States has been increasing by an annual average of some 1½ %; the unemployment rate went down from over 6½ % to just slightly over 4 %. In absolute figures, this meant an increase in the number of employees by some 16 million. Given an increasing labour force and an increase in the working population, this could be accomplished without a coordinated wage policy and reductions in working hours, without major employment schemes, and without the help of further training measures, which are often presented as indispensable features of a successful labour market policy in the context of the discussion in continental Europe. In the US, social standards are less well-developed compared with most European countries, meaning the pressure to take on less well-paying jobs is extremely high. Wage dispersion in the US, accompanied by a traditionally high mobility of labour, has increased distinctly.

... and at the United Kingdom

The United Kingdom represents a similar contrast to the corporatist approaches of some

5 Italy, which embarked on this route in the early nineties, is an exception of sorts. It remains to be seen whether this approach will succeed.

continental European countries. Since 1991, employment has been growing by an annual average of just under 1 %, and the unemployment rate dropped by more than two-and-a-half percentage points to some 6 % by mid-1999. This was largely attributable to thorough deregulation and privatisation of the economy, accompanied by a restructuring of the social systems (including reductions in the already comparatively low unemployment benefits) and a dismantling of tax burdens. The reform process was launched in the early eighties and continued despite some setbacks. However, the first sustainable success in the form of sharply rising employment without a wage-price spiral were not to be seen until the mid-nineties. As of late, the process of recovery has been accompanied by active labour market policy measures designed to combat the continued high level of long-term unemployment. As in the United States, the widespread absence of regulatory intervention in the labour market has led to increased wage dispersion.

Joint labour market policy initiatives for Europe?

European initiatives for more employment

Recently, the idea of a more intensive coordination of labour market policy in the euro area countries has gained increasing attention in the political arena. As early as in the context of the Single European Act in 1986, minimum requirements for the protection of the safety and health of employees as well as the promotion of social dialogue were agreed, and in 1993 the European Commission published a much-hailed White Paper on growth, competitiveness and employment. Moreover, in the 1997 Treaty of Amsterdam, employment policy was defined as a matter of Community interest. Accordingly, the responsibility for taking action remains at the national level but should be supplemented by a strategic coordination and European initiatives. This general goal is implemented through Employment Guidelines which, as a supplement to the Broad Economic Policy Guidelines, are also adopted by the European Council. Within this framework, National Action Plans are to be drafted and then presented to the Commission and the Council. The focal points of the first Employment Guidelines were reducing youth unemployment and preventing long-term unemployment. Finally, in 1999 the Cologne European Council summit passed the European Employment Pact, which combines the previous initiatives and, along with the newly introduced macroeconomic dialogue, is intended to contribute to reducing unemployment.

Limits of European employment policy

Apart from the fact that an exchange of experience under the aegis of the EU and the establishment of guidelines, including the associated pressure on governments to justify their actions, can contribute to improving the evaluation of concrete measures, the question arises as to how likely it is that more ambitious measures towards a coordinated employment policy can succeed. The experience gained so far has been so varied that the possibilities seem to be limited. For one thing, there are considerable differences in the problems faced by the various countries, and for another, there are significant disparities even within the (major) countries. Therefore, a single and maybe even binding strategy, which would naturally be incapable of taking account of the regional and sometimes historical differences, would probably soon be doomed to failure. Moreover, one may assume that in large, heterogeneous economies, corporatist solutions are unlikely to be successful on a sustainable basis. Therefore, there is much to be said for leaving the employment policy responsibility with each individual country and flexibly using local leeway to reduce unemployment.