International Labour Office

8th EUROPEAN REGIONAL MEETING LISBON

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Delivering decent work in Europe and Central Asia

Report of the Director-General
Volume I, Part 1

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The Report of the Director-General to the Eighth European Regional Meeting consists of two volumes. Volume I is entitled *Delivering decent work in Europe and Central Asia* and is divided into two parts. Part 1 provides an overview of recent world of work trends in the region. Part 2 contains seven background thematic chapters. Volume II is entitled *Towards decent work outcomes: A review of ILO work for 2005–08.*

Eighth European Regional Meeting
Lisbon, February 2009

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First published 2009

ISBN 978-92-2-121867-8 (print)
ISBN 978-92-2-121868-5 (web pdf)

Photocomposed in Switzerland JMB
Printed in Switzerland SRO

Preface

In October 2008, looming clouds burst into a fully fledged world financial, economic and social crisis. By the time the Eighth European Regional Meeting convenes in Lisbon, Portugal, in February 2009, the depth and breadth of the crisis will have been better assessed. Based on preliminary forecasts, most recent developments and lessons learned from previous crises, we can already surmise that the employment and social consequences will be severe. All regions will be affected.

Many governments are taking measures to stabilize the financial markets and to counter rapidly declining economic growth and weakening labour markets. Of foremost concern for the tripartite International Labour Organization is the impact of the crisis on the real economy, on enterprises and on working women and men.

The preparations for the Eighth European Regional Meeting have been overtaken by the unfolding crisis. The agenda of the Meeting will be adjusted to reflect the pressing need of the moment, namely the need to confront the crisis and design balanced policies that can cushion its worst effects on the most vulnerable and accelerate recovery.

Before the eruption of the financial and economic crisis, there was a looming crisis in the world of work, as a result of imbalanced growth models and policy agendas. Out of necessity, an opportunity has arisen to revise these policies. The ILO Decent Work Agenda offers an alternative in this regard.

This is the policy message of the ILO in adopting the Declaration on Social Justice for a Fair Globalization. The Declaration is as relevant during the upswings as it is during the downswings.

The European Union and the European Commission have both sent strong messages of support for the ILO Decent Work Agenda. Most recently, the Seventh Asia-Europe Meeting, in its Beijing Declaration on Sustainable Development of 25 October 2008, gave strong backing to the ILO Decent Work Agenda.

As we look towards the Eighth European Regional Meeting, I expect the tripartite constituency of the International Labour Organization in Europe and Central Asia to send a strong message on how to overcome the crisis by means of balanced economic and social policies developed through constructive dialogue.

Immediate action can be informed by recent achievements.

In 2005 in Budapest, governments and employers' and workers' organizations at the Seventh European Regional Meeting agreed "to work together through dialogue and cooperation to promote a common future of democracy, economic prosperity and social justice". Through ILO support, extensive dialogue and cooperation have taken place to further the goals of decent work for all across the region. Volume II of the Report to the Eighth European Regional Meeting provides examples of the tangible advances delivered in many countries. We know, however, that much remains to be done.

Volume I of the Report provides an in-depth review of recent trends in the world of work. It is divided into two parts. Part 1 offers an integrated overview of economic, labour and social policies and trends in the region. Part 2 contains seven background thematic chapters on economic, labour market and social challenges facing the region. These documents were being finalized as the full effects of the financial and economic crisis came to light. They therefore do not reflect recent developments.

The European Union has provided strong leadership in promoting decent work in the region and globally. Other countries in the region have their own benchmarks for implementing decent work policies.

Throughout the region, there is wide recognition of the value of social dialogue and tripartite consultations. This resource will prove especially valuable as governments, together with social partners, design policies to confront the crisis.

The Eighth European Regional Meeting can be instrumental in elaborating a strong message charting a balanced approach to sustainable growth and development based on decent work for all.

November 2008 Juan Somavia

Director-General

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Abbreviations

CIS	Commonwealth of Independent States
EU	European Union
EU-12	Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia
EU-15	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and United Kingdom
EU-27	Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and United Kingdom
Eurostat	Statistical Office of the European Communities
GDP	gross domestic product
ICT	information and communication technologies
WIIW	Vienna Institute for International Economic Studies
WTO	World Trade Organization

Introduction

Decent work has been a dominant theme across Europe and Central Asia for almost a decade. At the Sixth European Regional Meeting in 2000, ILO constituents committed themselves to making decent work a reality for everyone in the region. At the Seventh European Regional Meeting in 2005, the participants reaffirmed the role of the Decent Work Agenda in fostering balanced economic growth, enterprise development, employment, stability and inclusion. Strong expressions of support were voiced by the European Union (EU), by the United Nations and by a number of prominent European political leaders, from both the East and the West. As the region completes the first decade of the twenty-first century, looming economic slowdown and imbalances, following a period of relatively robust growth, place increasing emphasis on labour market outcomes. To sustain sound economic growth and cohesive societies, decent work, informed by ILO values and principles, remains a critical policy objective. The European Regional Meeting provides an invaluable platform to exchange views and experience on how to achieve this objective.

Declaration on Social Justice for a Fair Globalization

This general consensus has recently become far more precise and the level of commitment more resolute. At the international level, ILO constituents have recently defined in great detail what they mean by decent work and have precisely described what they expect from both ILO member States and the International Labour Organization in implementing the Decent Work Agenda. The ILO Declaration on Social Justice for a Fair Globalization was adopted unanimously at the International Labour Conference in June 2008.

European and Central Asian governments and social partners were at the forefront of the deliberations that led to this new Declaration.[1] For example, the Government representative of Slovenia – speaking on behalf of the EU – indicated that this was a historical moment when he warmly welcomed the adoption of the Declaration. He said:

> For the first time since the Declaration of Philadelphia, constituents have engaged in an overall reflection on the way in which the basic changes that have affected the international system have repercussions on the implementation of the ILO's mandate ... For the European Union, decent work is not a temporary, fashionable issue but a policy tool that structures the entire ILO agenda. Decent work is also an integral part of established policies, as agreed by all European Union institutions.[2]

The Employer Vice-Chairperson in the committee that negotiated the 2008 Declaration was Mr Julien, an Employers' delegate from France. Before the plenary of the International Labour Conference, Mr Julien indicated that it was with great joy and without reservation that the Employers' group of the ILO approved the Declaration. He stated that:

> For us, it is a policy document of the utmost importance with regard to the future of the Organization and its missions. The fact that this text was drafted on the basis of consensus and after considerable consultations, involving all States wishing to participate, shows that the ILO can meet challenges when it so wishes.
>
> The fact that the Workers' group and the Employers' group cooperated in an unprecedented fashion is also an element we must not forget.[3]

The Worker Vice-Chairperson was Mr Patel from South Africa. He described the Declaration as:

> the gift of this generation to the next, a belief that a different reality is possible, that instead of a world of income inequality, of high levels of unemployment and poverty, of vulnerability of economies to external shocks, of growth of unprotected work and the informal economy and the erosion of the employment relationship, we can build a world based on social justice.[4]

This unprecedented degree of consensus and optimism about the importance of the Declaration deserves to be matched by an equal degree of commitment in implementation.

Over the past decade, there has been much discussion among ILO constituents concerning the scope, definition and priorities within the Decent Work Agenda. The 2008 Declaration draws this debate to a fitting conclusion. ILO constituents have now resolved

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[1] Commission of the European Communities: *Report on the EU contribution to the promotion of decent work in the world*, July 2008, p. 9.
[2] ILO: *Provisional Record* No. 17, International Labour Conference, 97th Session, Geneva, 2008, p. 39.
[3] ibid., p. 36.
[4] ibid., p. 37.

debates about priorities within the Decent Work Agenda by declaring that the existing four strategic objectives of the ILO are "inseparable, interrelated and mutually supportive". This presents analytical, policy and operational challenges.

In respect of employment, an interesting feature of the Declaration is that emphasis has been placed on creating a sustainable institutional and economic environment in which:

> all enterprises, public or private, are sustainable to enable growth and the generation of greater employment and income opportunities and prospects for all

and

> societies can achieve their goals of economic development, good living standards and social progress.

In respect of social protection, an innovative feature of the Declaration is the consensus about the need for:

> the extension of social security to all, including measures to provide basic income to all in need of such protection, and adapting its scope and coverage to meet the new needs and uncertainties generated by the rapidity of technological, societal, demographic and economic changes;
>
> …
>
> policies in regard to wages and earnings, hours and other conditions of work, designed to ensure a just share of the fruits of progress to all and a minimum living wage to all employed and in need of such protection.

The section on social dialogue includes references to making labour law and labour institutions effective. In this context our constituents decided to emphasize the recognition of the employment relationship, the promotion of good industrial relations and the building of effective labour inspection systems – all issues that are relevant in the region.

Finally, the section on labour standards includes the following commitment:

> the violation of fundamental principles and rights at work cannot be invoked or otherwise used as a legitimate comparative advantage and … labour standards should not be used for protectionist trade purposes.

The main point to be made is that this renewed tripartite commitment in our Organization opens ways to move forward with a strong focus on delivering on the Decent Work Agenda.

This Meeting represents an opportunity for constituents of the European and Central Asian region to determine how they are going to deliver decent work in their part of the world based on a roadmap of social justice for a fair globalization.

Developing a concrete work plan for the implementation of decent work still remains a complex task, not least because the region is vast and diverse. It comprises 51 countries with diverse economic, political, social and cultural conditions. Constituents recognized four years ago that they were "bound by geography, history and shared ILO values". They agreed to work together "to promote a common future of democracy, economic prosperity and social justice".[5] Moreover, they decided that:

> Many elements of a common vision for Europe and Central Asia are shared by ILO constituents across the region. These include growth and competitiveness, more and better jobs and social cohesion, equality and fairness, and respect for fundamental principles and rights at work.[6]

Given the conclusions reached at the last European Regional Meeting and the heightened sense of consensus exhibited in the 2008 Declaration, the scene is set for a

[5] Conclusions of the Seventh European Regional Meeting, Budapest, February 2005, para. 4.
[6] ibid., para. 5.

constructive and concrete discussion about how to translate these decisions into practical policies and programmes in the 51 countries of Europe and Central Asia.

To assist with this dialogue, the Report prepared for this Meeting reviews progress, since the mid-1990s, towards decent work and the common vision outlined above. The Report highlights both important achievements and the challenges that remain. Part 1 also raises questions that the ILO constituents in the region may wish to consider as they discuss the next practical steps towards the full implementation of decent work and this common vision in their countries.

However, before reviewing these long-term trends it is important to place this discussion in context by considering recent economic, labour market and social developments.

Emerging economic challenges

This Report was written at a time of mounting economic uncertainty in Europe. By September 2008, the twin economic evils of recession and moderate inflation – or semi-stagflation – were real threats. Economic activity contracted in the euro zone in the second quarter of 2008. Some of the largest economies, including Germany, Italy and France, registered declines in gross domestic product (GDP). The largest Western European economies outside the euro zone – the United Kingdom and Sweden – also registered no growth in the second quarter.

Looking ahead, indicators of business and consumer confidence remain depressed. In October 2008, the International Monetary Fund published revised lower forecasts of economic growth: for the euro zone, the newly projected rates were lower by 0.4 and 1.0 points at 1.3 per cent in 2008 and 0.2 per cent in 2009, while for Central and Eastern Europe they declined by 0.1 and 1.1 points to 4.5 per cent (2008) and 3.4 per cent (2009), and for the Commonwealth of Independent States (CIS) by 0.6 and 1.5 points to 7.2 per cent and 5.7 per cent for the same years. In September 2008, the European Commission revised downwards its growth forecast for 2008 to 1.4 per cent in the EU-27, down from the 2.0 per cent forecasted in April 2008. Several countries in the region could well be in recession by the end of 2008. Inevitably lower growth will translate, with a time lag that will vary from country to country, into lower employment and higher unemployment.

By September 2008, annual inflation rates had risen to 3.6 per cent in the euro zone. This is above the European Central Bank target of "below but close to 2 per cent". The United Kingdom and Sweden also saw inflation rise slightly to about 4 per cent by mid-2008. Rapidly rising fuel and food prices have been the main factors boosting consumer prices. With a significant drop in oil prices by September 2008, the consensus expectation was that inflation was peaking, although the future outlook was difficult to predict.

What is clear is that the economic environment in the second half of 2008 and early 2009 will become very challenging for all countries in the region.

Against the backdrop of these developments, policy-makers have been struggling to clarify economic priorities and get the macroeconomic policy mix right. They face a dilemma in deciding whether recession or higher inflation represents the greater danger to economic stability and prosperity. In July 2008, the European Central Bank tightened monetary policy, but it kept interest rates on hold even after the meeting of its Governing Council in early October 2008.

This stands in stark contrast to the United States, where the Federal Reserve Bank has opted for pronounced fiscal and monetary expansion over the last two years to mitigate financial turbulence and slow growth. Indeed, the United States formula of aggressive cuts in interest rates and tax rebates was similar to the response applied during the economic slowdown of 2001, which rapidly restored economic growth in the United States economy. By mid-2008, the impact of the most recent counter-cyclical macroeconomic policies was once again evident. In the second quarter of 2008, GDP in the United States bounced back to an annual growth rate of 2.8 per cent, which made it once again the fastest growing economy in the G7. But inflation in the United States had jumped to 4.8 per cent in the third quarter of 2008 and the future outlook was more uncertain, despite the launch of the Government's rescue package worth US$700 billion for ailing financial institutions in October 2008.

In the euro zone, despite fears of an economic slowdown, the scope for counter-cyclical monetary and fiscal policy is constrained, as some countries have adopted stronger fiscal stances than others. Various options can be considered to maximize the growth, welfare and employment consequences of any fiscal stimulus. Responses obviously need to be country-specific.

It is important to note that the recent pickup in inflation stems almost exclusively from exogenous forces, particularly rising fuel and food prices. It is equally clear that most economies in the region, particularly in the EU-15, are not over-heating and that wage adjustments have not so far contributed to inflationary pressures. The concern among central bankers obviously lies with the "pass through" effects of exogenous price increases, which may generate additional inflationary expectations through nominal wage adjustments. The concern lies with the price–wage–price spirals witnessed in decades gone by.

So far there is little evidence in the EU-15 countries that real wages have been boosted. In fact, as we will see later in this Report, real wage growth across the region has failed to keep pace with productivity improvements over the past decade, leading to a significant decline in the wage share and record profit levels in many countries.

Moreover, it would seem that the recent price hikes are already affecting the disposable incomes and living standards of workers and families in many countries in the region, thus exacerbating concerns about purchasing power and income inequality. There are justifiable concerns that economic and employment growth may be severely constrained in the period ahead by declining consumption expenditure. It is thus interesting to observe that some central bankers outside the European Central Bank, including the Bank of England, have been reported as believing that the erosion of take-home pay will be the biggest constraint on economic growth in the period ahead.[7]

In this context, it would seem appropriate for labour ministers and the social partners to be part of the macroeconomic policy discussion, particularly if they can make a constructive contribution which will boost consumer and investor confidence in the current environment. The final sections of this Report will provide some suggestions about how social dialogue might contribute in the emerging economic circumstances to creating slightly more policy space to tackle inflation and slow growth simultaneously.

Appropriately, the 2008 Declaration recalls that the ILO has a "responsibility to examine and consider all international economic and financial policies in the light of the fundamental objective of social justice".

[7] D. Strauss: "'Competition in misery' for gloomy UK and neighbours", in *Financial Times* (London), 15 Aug. 2008.

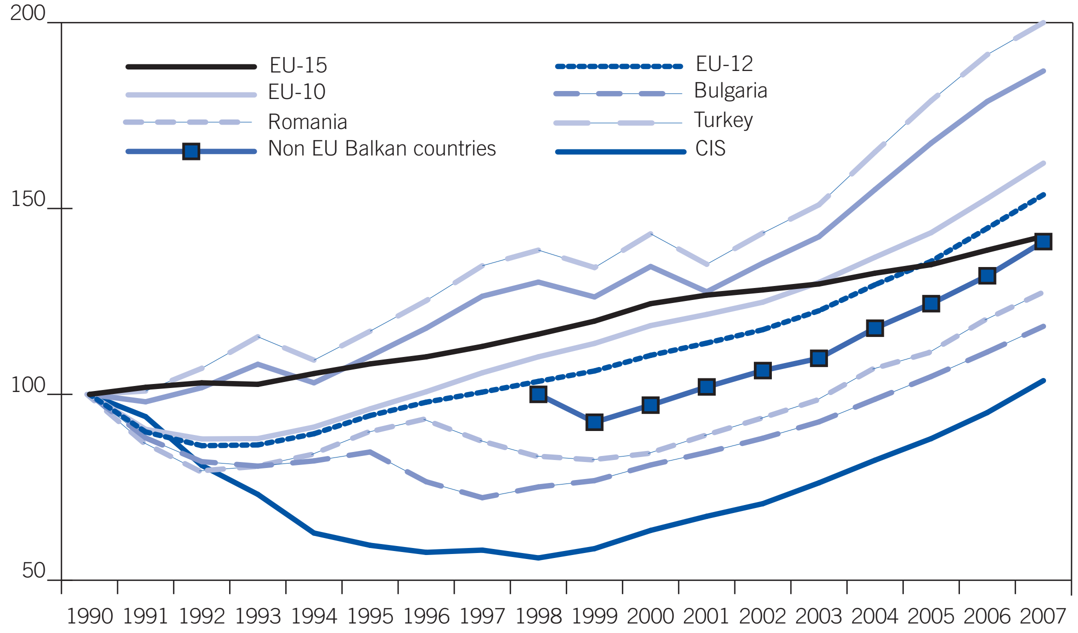
Economic catching-up in Central and Eastern Europe

We now turn to examine longer term economic and labour market trends.

The European and Central Asian region has been on an economic roller coaster since the early 1990s. There have been significant unsynchronized swings in economic growth within and across subregions.

For example, in the latter half of the 1990s, the EU-15 enjoyed relatively robust growth rates, with GDP increasing on average by 2.8 per cent per year, compared to 1.6 per cent in the first half of the 1990s. Thereafter, growth slowed in the EU-15 and averaged just 1.6 per cent per year over the period 2001–05, before bouncing back in 2006 and 2007 (see figure 1). As noted above, this trend has now reversed again with a high risk that the subregion may be in recession before the end of 2008.

Figure 1. Growth of GDP, 1990–2007 (index from beginning of available data)



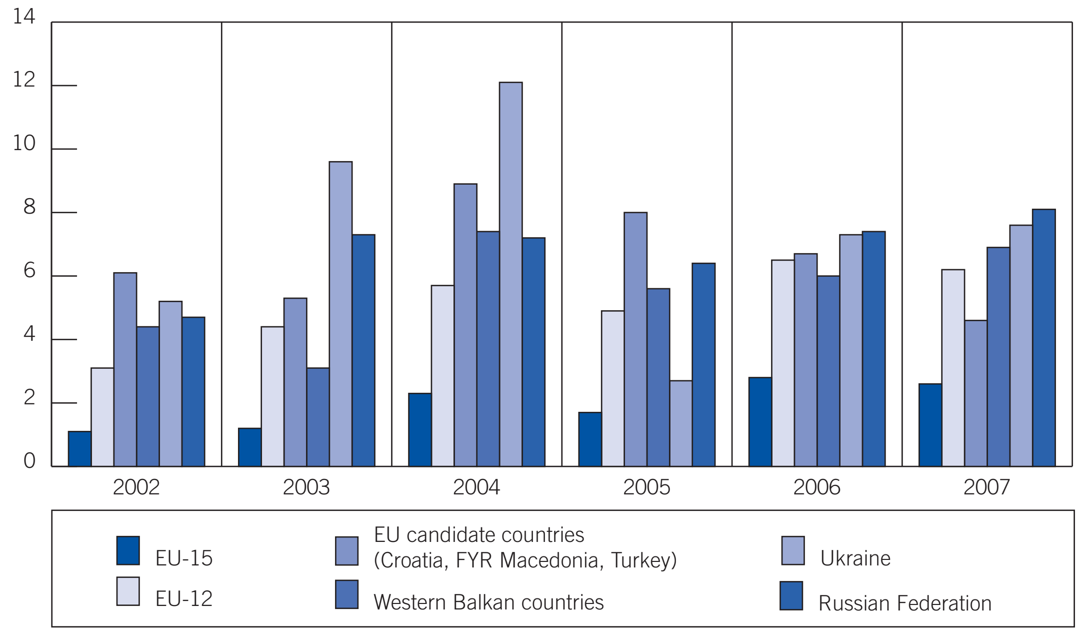
Note: The EU-10 here are the new EU Member States (EU-12) without Bulgaria and Romania.

Source: Vienna Institute for International Economic Studies (WIIW) database; Statistical Office of the European Communities (Eurostat); statistics of the CIS.

Economic growth trends elsewhere in the region have fluctuated more dramatically. As a group, the EU-12 established a substantial and persistent economic growth differential over the EU-15 in the 2000s. Moreover, starting from about 2001–02, the CIS, the non-EU Balkan countries (with one or two exceptions) and Turkey have embarked on a sustained growth track (see figure 1).

Given this record of impressive economic growth in recent years, many observers believe that a wide range of non EU-15 countries in the region have started the process of catching-up, or economic convergence, with the more affluent countries of Western Europe. This process is depicted in figure 2, where it can be seen that the growth rates of the non EU-15 countries exceed those of the EU-15 economies. From figure 2, it is clear that virtually all subregions (EU-12, EU candidate countries, other non-EU West Balkan economies, Turkey and the two CIS economies – the Ukraine and the Russian Federation) have embarked on a path that shows a 2.5 to 3.5 point growth differential compared to the EU-15 over the most recent period.

Figure 2. Growth of GDP, 2002–07 (% annual change)



Source: WIIW database, incorporating national statistics; Eurostat.

Two important caveats are warranted. First, the recent relatively faster growth rates in the non EU-15 countries have occurred from a low base following a decade of slow growth or economic contraction. Second, it is unclear at this stage how sustained this process of economic catching-up will be. For example, it is unclear how the emerging threats of inflation and recession (discussed above) will impact on the relative growth performances of the various subregions in the next few years.

Nevertheless, the fact that the region has started economic convergence in the last half decade is hugely encouraging. Economic and social policies should aim to maintain, and, if possible, accelerate these trends. To do so, however, it would help to understand the factors that have been behind the economic convergence experienced to date and how employment and labour productivity developments have contributed to economic growth in the various parts of the region.

Divergent productivity trends

One important factor facilitating economic catching-up is the great potential for rapid productivity growth in lower income economies. In recent years, this potential has been realized through stable macroeconomic policy, trade liberalization and foreign direct investment, which have encouraged technology transfers. Productivity levels are a function of access to new technology, interpreted in a wide sense. This includes equipment and techniques of production, as well as organizational practices that allow a more efficient use of labour.

The transfer of knowledge, the ability to implement new production techniques and the adoption of better organizational practices have occurred rapidly and have made it possible to catch up with more mature economies. The routes of faster knowledge and technology transfer are manifold.

Firstly, access to knowledge has become much easier and cheaper due to the revolution in information and communication technologies (ICT), the much greater mobility of skilled personnel, the international mobility of students and the international diffusion and streamlining of training programmes and study curricula.

Secondly, trade liberalization and increased foreign direct investment are important vehicles of technology diffusion. This includes imports of capital goods, other intermediate goods and the dissemination of organizational practices through multinational companies. Subcontracting, whereby multinational or other leading companies transfer technology to their suppliers – or force their suppliers to purchase the latest technology and upgrade their products and services – is also part of this process. Access to high-income markets – made possible by trade liberalization – also serves as a well-known mechanism to upgrade products to the requirements of more sophisticated markets.

Thirdly, there is scope for greater international dissemination of institutional and legal norms, which provide an institutional and behavioural anchorage to catching-up economies. The *acquis communautaire* is probably the most elaborate form of such institutional anchorage in today's global economy. The *acquis* not only acts as a compulsory institutional and legal framework for EU Member States, but is also partially implemented by other economies, whether candidates or even countries with an outside chance of becoming Member States. Several countries outside the EU have experienced a similar effect from accession to the World Trade Organization (WTO), or ongoing accession.[8] The new WTO member States and candidates for accession had to reform their legislation, regulating such areas as monetary and fiscal policy, investment regime, privatization, pricing and competition policy.

It is clear that the importance of the above factors differs greatly across countries in the region with respect to: the absorption capacity of new technology and organizational practices; the nature of product specialization; the absence or availability of raw materials; and the potential for product upgrading. And they differ, of course, in the extent to which

[8] The following countries from the region have recently joined the WTO: Armenia (2003), Croatia (2000), Georgia (2000), Republic of Moldova (2001) and Ukraine (2008). Azerbaijan, Kazakhstan, Montenegro, Russian Federation, Serbia, Tajikistan and Uzbekistan are in the accession process.

anchorage in European and international institutional frameworks affects their paths of economic development.

Globalization and past reforms have facilitated the spread of technology, in its broad definition, and thus economic convergence across the region. An important factor continues to be the combination of relatively high levels of productivity with relatively low labour costs. To maintain progress towards economic convergence, it will be important for national and regional policies to maintain and build upon the scope for technology transfer and productivity improvements in the lower income countries. Thus the preservation of open economies, a genuine commitment to skills enhancement, plus continued political stability and institutional convergence, are essential preconditions for further economic catching-up across the region.

Real annual GDP growth in the EU-12 countries averaged 4.1 per cent over the period 1995 to 2007, compared with 2.3 per cent in the EU-15 countries (see table 1). Productivity growth in the EU-12 was almost 4 per cent a year over the period from 1995 to 2007. In comparison, the EU-15 countries as a whole recorded average productivity growth of just 1.4 per cent a year over the same period.

The appendix provides more detail on country-level productivity trends. It is clear that virtually all the Central and Eastern European countries in the EU-12 have recorded impressive productivity improvements since the mid-1990s. Moreover, there is no sign yet that this trend is petering out.

For the CIS, the Western Balkans and Turkey, the only available data on labour productivity is measured as GDP per worker. With this difference in mind, it shows similar considerable productivity improvements to the EU-12. For the CIS as a whole, the average annual labour productivity growth rate equalled 4.9 per cent during the period 1996–2005, although with vast inter-country diversity, ranging from 3.8 per cent for the Russian Federation to 10.7 per cent for Azerbaijan and 12.4 per cent for Armenia. Turkey recorded a slightly lower 3.7 per cent increase in this indicator for the same period, while labour productivity grew by 5.3 per cent annually in the Western Balkans between 2000 and 2006.

Table 1 also sheds light on the relatively modest productivity performance in the EU-15 since the mid-1990s compared to other economically advanced countries. This came after a prolonged period during which the EU-15 had performed better than the United States in terms of labour productivity and was therefore closing the "productivity gap" between the EU and the United States. But from 1995 onwards this gap has again widened. Indeed, over the past decade the EU-15 countries have recorded very modest labour productivity growth, while the United States has dramatically improved its productivity performance (see figure 3).

Considerable research has been devoted to analysing the reasons behind these trends. This research suggests that the relatively better productivity performance in the United States can be explained by the more rapid production and diffusion of ICT compared to the EU-15 countries over the last decade. ICT is generally seen as general-purpose technology that can generate a wide spectrum of secondary innovations and applications in the form of organizational change and new working patterns.

However, this factor can explain only part of the relative decline in labour productivity growth after the mid-1990s in the EU-15. Annual labour productivity growth had averaged 2.2 per cent a year between 1987 and 1995 in the subregion, but this fell to just 1.4 per cent between 1995 and 2007. Although "old" Europe might have been less able to utilize the productivity enhancing potential of ICT as fully and as rapidly as the United States, thus explaining the relative outcomes on opposite sides of the Atlantic, the new technology

Table 1. Growth of labour productivity, real GDP and total hours worked

	United States	EU-15	EU-12	EU-27	Japan
Labour productivity growth (GDP per hour, annual average, %)					
1987–95	1.2	2.2	–	–	3.2
1995–2007	2.1	1.4	3.9	1.8	1.8
of which:					
2000–07	2.0	1.2	4.4	1.6	1.9
2005	1.5	1.0	2.7	1.0	2.1
2006	1.0	1.5	4.1	1.7	1.3
2007	1.1	1.3	3.5	1.4	1.4
Growth in total hours worked (annual average, %)					
1987–95	1.6	0.1	–	–	-0.2
1995–2007	1.0	0.9	0.1	0.7	-0.5
of which:					
2000-07	0.4	0.8	0.4	0.7	-0.4
2005	1.5	0.6	2.0	0.9	-0.2
2006	1.9	1.3	2.3	1.6	0.9
2007	1.2	1.4	2.5	1.7	0.4
Real GDP growth (annual average, %)					
1987–95	2.7	2.3	–	–	2.9
1995–2007	3.1	2.3	4.1	2.5	1.3
of which:					
2000-07	2.4	2.0	4.8	2.3	1.5
2005	3.1	1.6	4.8	2.0	1.9
2006	2.9	2.8	6.4	3.2	2.2
2007	2.3	2.7	6.1	3.1	1.9

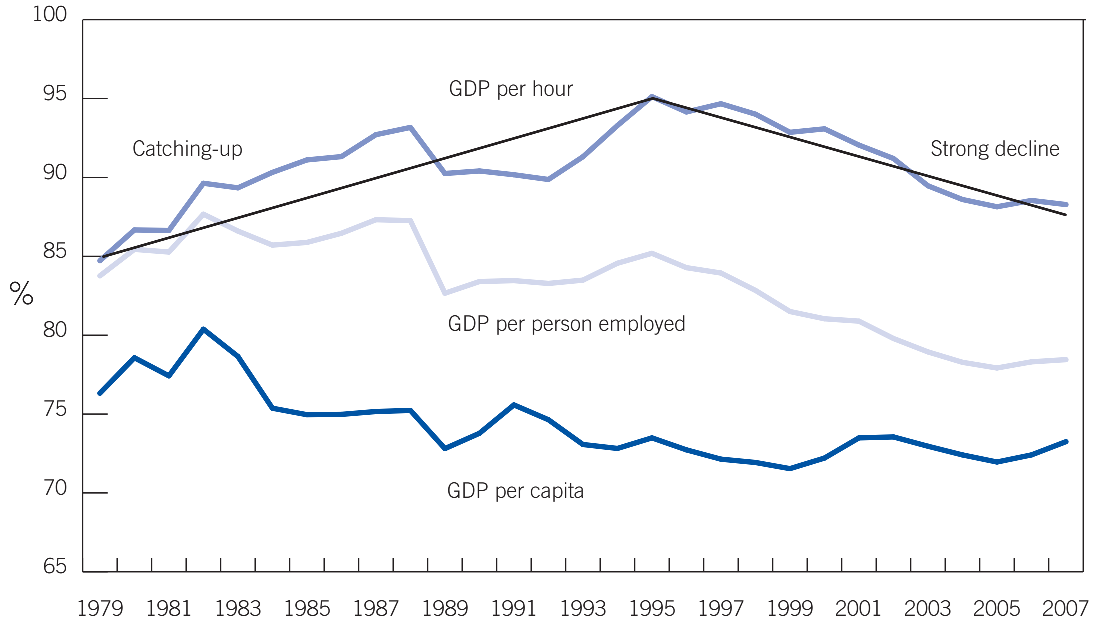
Source: The Conference Board and Groningen Growth and Development Centre, Total Economy Database, Jan. 2008.

cannot be solely held responsible for the slowdown in productivity growth within the EU-15. We also have to look for other explanations.

Interestingly, the latter period of poor labour productivity performance has coincided with a significant improvement in labour market outcomes in the EU-15. This will be discussed in detail below. Table 1 illustrates how total hours worked in the EU-15 countries were virtually stagnant in the period prior to 1995, but have increased by nearly 1 per cent a year since then. Indeed, based merely on trends in total hours worked, it could be claimed that EU-15 labour market performance has virtually matched that of the United States since the mid-1990s, whereas between 1987 and 1995 there was a vast gulf between the two.

Real average annual GDP growth in the EU-15 countries remained constant at 2.3 per cent in the two periods before and after 1995. However, in the earlier period

Figure 3. Productivity developments, United States and EU-15, 1979–2007 (United States = 100%)



Source: The Conference Board and Groningen Growth and Development Centre, Total Economy Database, Sep. 2008.

economic growth in the subregion was often described as "jobless", albeit with robust productivity growth and significant simultaneous job destruction and creation. In the more recent period, productivity growth has been subdued but the quantity of hours worked has expanded significantly.

The important coincidence since 1995 of improved labour market outcomes and deteriorating productivity performance in the EU-15 calls for more detailed analysis.

Table 2 contains additional information that can help clarify recent developments. The table provides data for the EU-15 as a whole, as well as for various subregions within the EU-15. The decline in labour productivity and total factor productivity after 1995 is evident across all the subregions of the EU-15. However, the productivity slowdown is not homogenous and appears more pronounced in what have been termed the Mediterranean countries (Greece, Italy and Spain) for the purposes of the table.

Since the mid-1990s, the EU-15 has recorded declining growth rates in the ratio of capital to total hours worked (K/H) as well as capital to output (K/Y) compared to the pre-1995 period. Again, this trend is clear in all the subregions of the EU-15, but appears slightly more pronounced in the Mediterranean subregion.

This information would suggest that the EU-15 countries became more labour intensive and less capital intensive in their choice of production techniques after the mid-1990s. As we will see later, this has coincided with a high degree of real wage restraint in the EU-15, with real unit labour costs and the share of national income going to labour declining in the past decade. Those countries with the greatest degree of real wage restraint over the last decade were the same countries that experienced the most significant slowdown in productivity growth and capital to labour ratios.

Table 2. Growth of labour productivity and selected factors explaining its development

	EU-15	Continental (a)	Mediterranean (b)	Anglo-Saxon (c)	Nordic (d)
1980–95 growth rates					
Labour productivity (Y/H)	2.34	2.46	2.07	2.46	2.30
Capital per hour (K/H)	3.68	3.47	3.52	4.44	4.06
Capital deepening (K/Y)	1.11	1.07	1.05	1.25	1.23
Total factor productivity (TFP)	1.23	1.39	1.02	1.21	1.07
1995–2004 growth rates					
Labour productivity (Y/H)	1.41	1.63	0.63	2.11	1.92
Capital per hour (K/H)	2.81	2.99	2.01	3.99	2.86
Capital deepening (K/Y)	0.95	1.01	0.73	1.2	0.96
Total factor productivity (TFP)	0.46	0.63	-0.10	0.91	0.96

Notes: Country groups: (a) Continental: Austria, Belgium, France, Germany, Luxembourg, Netherlands, Portugal* (49%); (b) Mediterranean: Greece, Italy, Spain (29%); (c) Anglo-Saxon: United Kingdom, Ireland (17%); (d) Nordic: Denmark, Finland, Sweden (29%); numbers in brackets refer to shares of EU-15 population in 2005.

Y/H = GDP per hour; K/H = capital per hour; K/Y = capital to output (GDP).

* The inclusion of Portugal in the Continental rather than the Mediterranean group by I. Dew-Becker and R. Gordon is not obvious. However, given the relative size of its economy, it does not significantly affect the features presented in table 2.

Source: EU KLEMS Database, drawn from I. Dew-Becker and R. Gordon: *The role of labor market changes in the slowdown of European productivity growth*, working paper 13840 (Cambridge, MA, National Bureau of Economic Research, 2008), table 2.

The increase in total hours worked in the EU-15 over the past decade is reflected in significant increases in labour market participation rates and employment rates. The improved employment performance coincides with, and is at least partly an outcome of, a significant increase in atypical forms of employment, in particular part-time and temporary work, which tend to be less productive due to the lower access of workers in these types of jobs to training and skills development, as well as their lower loyalty to their company and motivation to seek productivity improvements. If substantiated, this would support the view that the decline in productivity growth can be linked to the improved employment scenario after 1995.

Improving employment performance

Rapid economic growth, productivity advances and the convergence of GDP levels are important in themselves, but not sufficient to ensure social cohesion and stability. The way in which the benefits of economic growth are distributed, particularly in the lower income countries, will determine the extent to which economic catching-up is translated into social convergence. Social progress commensurate with economic progress is required to ensure there is broad public support for policies that permit rapid productivity improvements in the lower income countries. Social justice and decent work are important to preserve public support for open economies and other policies that make productivity improvements and economic convergence possible.

Important progress has been made in expanding the quantity of employment, measured in terms of labour force participation, total hours worked and employment and unemployment rates. However, progress in these areas is uneven across countries, over time and between different groups in the labour market.

Since the launch of the Lisbon Strategy in 2000, about 10 million jobs have been created in the EU-15. Employment and labour force participation rates have increased substantially: the former from 59.9 per cent in 1995 to 67.0 per cent in 2007, and the latter from 67.2 per cent to 71.6 per cent over the same time horizon.

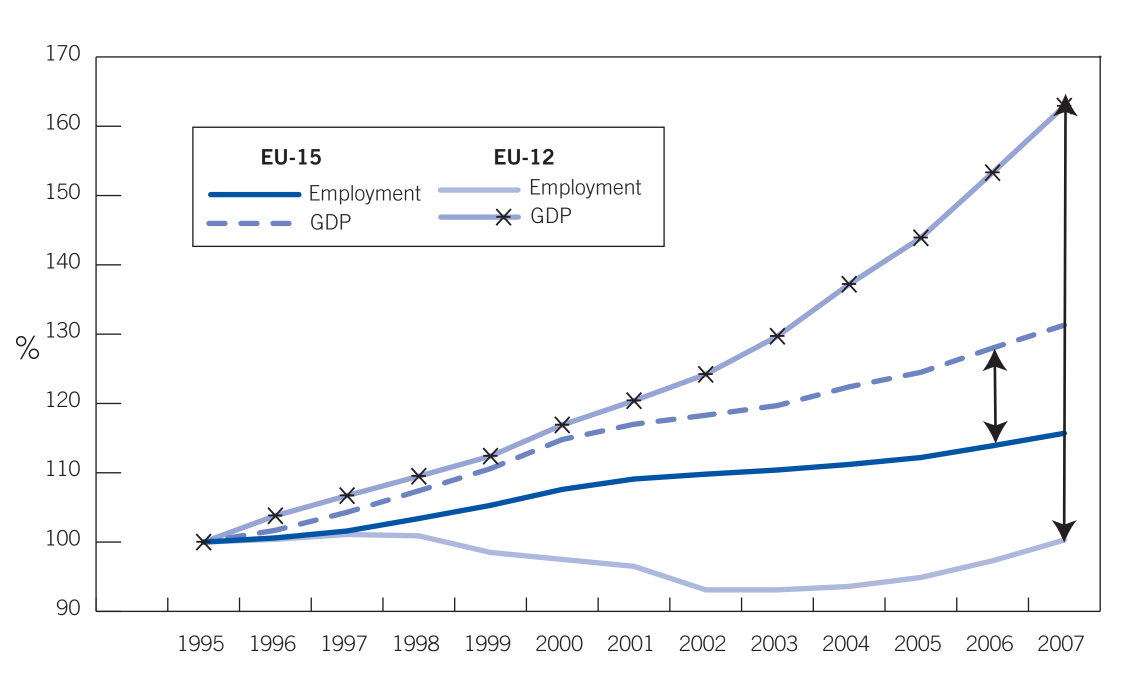
The recent favourable evolution of the employment rate in the EU-15 is apparent when comparisons are made with the United States and Japan. Three decades ago the employment rates of the three were nearly equal at about 73 per cent. But by 1994, the employment rate in the EU-15 stood 10 points below the rate of Japan and 12 points below that of the United States. Since the mid-1990s, there has been a dramatic reversal. By 2006, the gap had shrunk to 4.6 and 6.0 points, respectively. In other words, the gap has been reduced by half within just over a decade.

In other parts of the region, labour market trends have been more erratic. The EU-12 countries have made considerable progress in the last few years. But when examined over the longer term, the employment picture within the EU-27 remains diverse. This is illustrated by comparing long-term trends in economic growth and aggregate employment between the advanced EU-15 economies and the EU-12 catching-up economies.

Figure 4 plots GDP and aggregate employment developments in the EU-15 and in the EU-12. What we see is a strong discrepancy in outcomes between the two subregions. The EU-15 had moderate cumulative GDP growth over the period 1995-2007 of slightly above 30 per cent, while the EU-12 experienced cumulative GDP growth of over 60 per cent over the same period. But when we examine aggregate employment trends the situation is dramatically reversed. The EU-15 experienced positive employment growth of about 18 per cent, while the EU-12 ended up in 2007 just about where they were in 1995. In other words, over the medium term there was no employment growth, or what is called "jobless growth", in the new Member States, linked to simultaneous job destruction and creation.

How are these striking differences in relative output and employment developments between the new and old Member States of the European Union to be interpreted? There

Figure 4. Employment and GDP growth (1995 = 100%)



Source: WIIW database incorporating national statistics; Eurostat.

is a simple answer to this: the relative output-to-employment ratio is the flip side of the productivity trends discussed above.

Employment trends in some of the other subregions over this extended period are even more diverse. The Russian Federation and the Ukraine have enjoyed a substantial rise in employment following the crisis in the late 1990s. But countries in South-Eastern Europe have suffered from stagnation or deterioration. Turkey, as well as most of the Western Balkan countries, has been plagued by "jobless" growth (see Chapter 2, Part 2 of this Report).

The fact that the EU-15 subregion exhibited such a positive employment record in recent years is at variance with the pessimistic predictions about EU labour markets made five or ten years ago. A major focus of the Seventh European Regional Meeting in 2005 was the debate about balancing flexibility with security in the labour markets of Europe and Central Asia. It was observed then that, within the region, no consensus had ever emerged in favour of far-reaching labour market deregulation and instead a more moderate position had emerged "that gives credit to European labour market institutions, while not entirely dismissing the positive effects of labour market flexibility on employment and unemployment".[9]

Although the region as a whole has significantly improved its employment performance in the last few years and several countries have exhibited a particularly strong expansion of job opportunities, there are notable weak spots. Many countries have so far failed to reach the EU target rates for employment set for 2010, and in the other subregions the situation is significantly worse.

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[9] ILO: *Managing transitions: Governance for decent work*, Report of the Director-General, Vol. II, Seventh European Regional Meeting, Budapest, 2005, p. 53.

More disaggregated labour market data reveals both encouraging and discouraging signs. On the plus side, there has been a dramatic improvement in women's employment rates over the past decade. This is particularly true within the EU-15, where the female employment rate increased by some 9 points between 1995 and 2006 (over the same period the male employment rate rose by about 3 points). There has also been significant progress in the labour force participation and employment rates of older workers aged 55–64. In the EU-15, the employment rate among this older age cohort rose by 9.4 points between 1995 and 2006. Unfortunately the employment rates of young workers aged 15–25 have evolved much less favourably. Youth unemployment remains a pervasive problem across the whole region.

Moreover, as previously discussed, there is concern that the positive employment trends of recent years will not be sustained in the face of faltering economic growth and emerging inflationary pressure. Economic developments in 2008 confirm that the business cycle remains relevant.

Another factor that will increasingly influence the labour market situation in the region is demographic change. Population ageing is a reality in many countries of Europe and Central Asia, implying absolute declines in the projected labour force by 2020. A major difference between Europe and North America lies precisely in the much lower rates of labour force growth, respectively -0.3 per cent annually in Europe over 2005–20 against 0.6 per cent in North America.

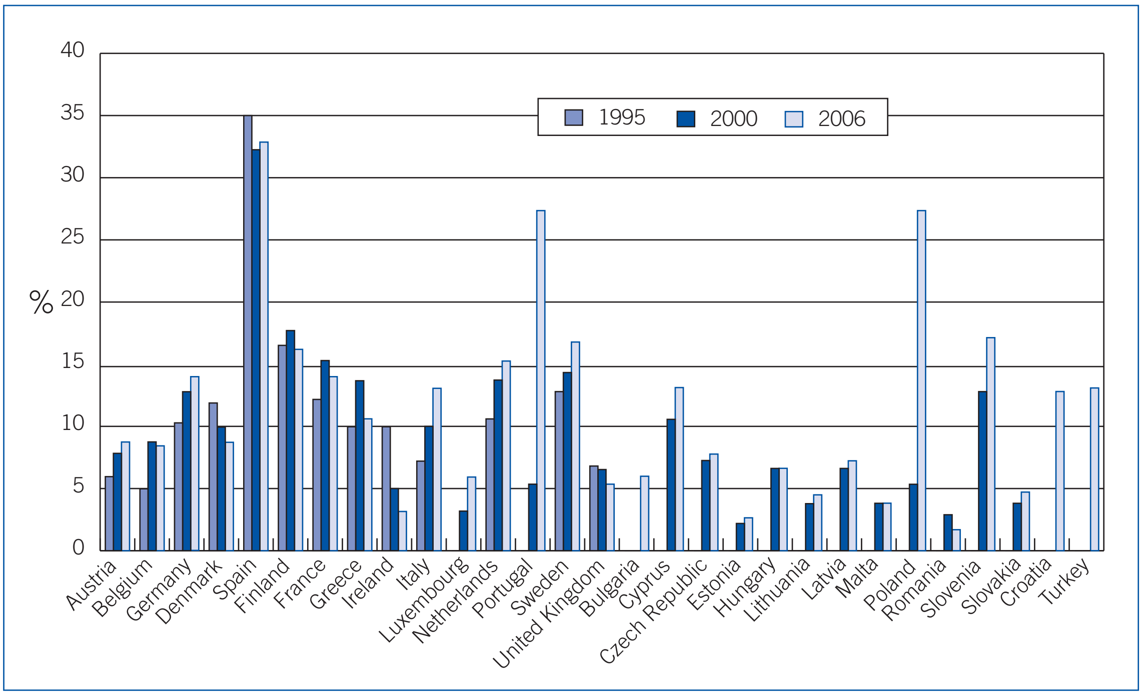
Demographic projections point to significant absolute declines in population in the Russian Federation over the coming decades. Moreover, labour shortages, in particular of skilled labour, are already affecting not only all the new EU Member States, but also some non-EU countries of South-Eastern Europe and Eastern Europe, with implications for future investment and growth.

Growth of atypical jobs

Non-standard forms of employment have played a significant part in the expansion of employment across the entire region in recent years. There are various forms of non-standard employment contracts: part-time employment; fixed-term, seasonal or casual temporary work, including agency work; telework and specific forms of self-employment that are actually disguised employment; as well as work in the informal economy. However, the precise composition of non-standard jobs differs between subregions and from country to country.

Over the period 1995 to 2006, the proportion of workers in temporary employment [10] jumped by about 25 per cent in the EU-15. In 1995, temporary employment represented 11.8 per cent of total employment in the subregion. By 2006, the corresponding figure was 14.7 per cent. Interestingly, the concentration of male and female workers in temporary jobs is fairly even. There has also been a significant expansion in temporary work in the EU-12 (see figure 5), as well as in the West Balkan and CIS countries. In Poland temporary work increased fivefold between 2000 and 2006, while in the Russian Federation temporary employment increased from 2.3 to 6.0 per cent of total employment between 1995 and 2004.

Figure 5. Temporary employees as a percentage of total employees



Source: Eurostat.

[10] Due to data constraints, temporary employment is identified here with employment on fixed-term contracts.

There are many disadvantages for workers in temporary jobs compared with people doing the same job but engaged on a regular employment contract. These often include lower pay and less job security; less access to training and services for employees provided by the enterprise, such as childcare facilities; lower coverage by social security schemes;[11] fewer opportunities for promotion in employment; and difficulties in gaining access to housing loans offered by financial institutions.

The incidence of temporary work is particularly high among youth aged 15–24. In Slovenia, two-thirds of young people had fixed-term contracts in 2006, over twice as many as in 1995. There also appears to be a trend towards shortening the duration of temporary contracts. As temporary contracts become shorter, the level of insecurity in the labour market mounts.

Agency work, whereby workers are employed on a temporary basis by an employment agency, but actually carry out their work in an "end-user" enterprise, is one form of temporary work that is expanding rapidly. Data on the number of temporary agency workers is incomplete, but the figures that are available indicate a steady increase in this type of work. In the EU-27, the number of agency workers was estimated at 8 million in 2006, which represents 3.8 per cent of total employment.

Agency work is one example of a triangular employment relationship. In these circumstances, there is often a lack of clarity about who is responsible for ensuring that workers receive the benefits and rights to which they are entitled. This need not be the case however. In some countries, such as the Netherlands, agency workers enjoy access to social security schemes and other rights in the same way as workers on regular contracts. However, in other countries agency workers – as well as other workers engaged through a triangular employment relationship – do not receive access to social security and are often discriminated against in the remuneration they receive. Workers in this situation often report other abuses of contractual rules. The agreement reached in June 2008 between EU Member States concerning the working conditions of temporary agency workers should provide them with more security and better working conditions. Agency workers in other parts of the region, as well as workers engaged in other forms of triangular employment relationships, require similar protection.

Part-time work[12] has also increased dramatically in the EU-15 over the past decade. By 2006, one in every five jobs in the subregion was part time. The trend towards more part-time work accelerated in the subregion after 2000. However, there remain remarkable differences in the proportions of part-time work in total employment across the EU-15. The ratio ranges from a low of 5.7 per cent in Greece to 46.2 per cent in the Netherlands. In contrast, part-time work remains limited in the EU-12, as well as in South-Eastern Europe and the CIS.

Part-time work is heavily gendered in nearly all countries. In 2006, almost 37 per cent of all women in paid employment in the EU-15 were working part time. In comparison, just 7 per cent of men worked part time in the subregion. Part-time jobs, like temporary employment, are frequently of lesser quality than similar full-time jobs. For example, hourly wages, non-wage benefits, social protection coverage and even training and career development opportunities are often lower than in the same jobs that are performed full time.

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[11] The issue of the portability of social security and health-care schemes is also important, since many large companies have private schemes or make enterprise contributions to the occupational pillar of the national pension scheme, but only for permanent contract holders or those with contracts of longer duration.

[12] In this context, part-time employees are understood to be those who do not perform a full day's work or do not complete a full week's work.

Beyond the borders of the EU, there is no comparable data on part-time work. However, several countries in the region outside the EU have been experiencing a phenomenon that can best be described as reduced working hours – effectively part-time work – determined by the needs of enterprises. In the Ukraine, for example, reduced working hours affected 39.4 per cent of the workforce in 1999, and although the figure has declined since then, the phenomenon still affects substantial portions of workers in certain industries, such as transport and communications (23.3 per cent of employees), construction (21.9 per cent) and manufacturing (17.5 per cent – all data for 2004).

Self-employment is one form of atypical work that appears to be diminishing in many countries. Over the period since the mid-1990s, self-employment has fallen in 23 of the 28 EU Member States and candidate countries for which comparable data is available, while it has remained stable in three other countries. Only four countries have recorded a modest increase in self-employment in this period: Slovakia, Czech Republic, Netherlands and Germany.

It is worth noting that the incidence of self-employment tends to be higher in Southern European countries and in countries with higher shares of employment in agriculture, such as Romania, Greece (where over 40 per cent of all workers are self-employed), Bulgaria, Poland, Portugal, Croatia, Cyprus, Ireland and Italy. At the other end of the scale, Sweden, Luxembourg, Denmark, Estonia and France have self-employment levels below 10 per cent of total employment. Available data for the CIS shows divergent trends. For example, in the Russian Federation the share of self-employment declined marginally from 8 to 7.6 per cent between 2001 and 2007, while in the Ukraine self-employment increased from 6.9 to 17.6 per cent over the period 1999–2006.

These trends tend to broadly support the view that wage employment becomes the preferred form of employment as economic development and incomes rise.

Rising atypical employment reinforces the importance of the ILO Employment Relationship Recommendation, 2006 (No. 198), which calls on member States to adopt a national policy for reviewing regularly – and if necessary adapting – the scope of relevant laws and regulations in order to guarantee effective protection for all workers in an employment relationship, regardless of its form, by ensuring standards applicable to all forms of contractual arrangements, including those involving multiple parties, and combating disguised employment relationships. The expansion of voluntary part-time employment can help ensure a better balance between work and family responsibilities and facilitate the labour market participation of older workers, as well as of people combining work and further study.

However, in far too many cases women's part-time work can be traced to inadequate childcare facilities or short opening hours, which make full-time employment an unrealistic option. The road towards equality for part-time workers involves the "normalization" of part-time work – which includes granting part-time workers similar rights and benefits (such as pro-rata earnings and non-wage benefits) to full-time workers in similar positions. An important mechanism for improving the quality of part-time work is therefore the use of equal treatment regulations in employment, non-wage benefits and social protection systems, as well as the extension of part-time work into a broader range of occupations and positions. To the extent possible, the same principles should apply to other atypical forms of work, including temporary work.

Another important positive aspect of atypical work is that it can be a stepping stone to regular employment. For example, temporary work can provide an employer with an opportunity to give young workers the chance to demonstrate their capabilities and gain valuable work experience. Such opportunities may not exist in a labour market that prohibits or restricts the ability of employers to create temporary jobs.

On the other hand, in many cases this transition from atypical forms of employment to regular employment does not eventuate and workers remain stuck in jobs with less security, fewer training and career opportunities, lower wages and restricted access to non-wage and social benefits. Based on the available data for the EU-15 over the period 1995–2001, it appears that on average only one-third of persons holding temporary contracts were able to move to regular employment contracts. However, there are significant cross-country differences. For example, in Luxembourg and Austria over 50 per cent of temporary contract holders moved to regular contracts, while in France the figure was just 20 per cent.

The expansion of atypical employment contracts – such as temporary, part-time and agency work – should be the result of genuine choices. For this to be the case, these forms of work should be covered by social protection and incentives should exist to help workers who so desire move into regular full-time jobs. Some countries, such as Spain in 2006, altered their labour laws – with the agreement of the social partners – to limit the repeated renewal of temporary contracts and to offer incentives to enterprises to convert fixed-term contracts into regular contracts.

In the past it has sometimes been claimed that the growth of atypical forms of employment was a result of excessive employment protection, such as regulations governing dismissal or prescribed levels of severance payment, which makes employers reluctant to hire workers on regular employment contracts. However, in recent years there has been a trend towards more liberal employment protection legislation, yet the expansion of atypical forms of work has been maintained or accelerated. This is particularly evident in the EU-12 where, on average, employment protection legislation is now less stringent than in the EU-15 region. Yet it is in this subregion that there has recently been a dramatic expansion in temporary work.

Moreover, recent ILO research suggests that within the region, and particularly in the EU-12, the strictness of employment protection legislation has no significant impact on aggregate, long-term or youth unemployment rates. On the other hand, other labour market institutions do have an important impact. For example, active labour market policies have a significant positive impact and can help reduce unemployment, while high labour taxes seem to be associated with increased unemployment. This evidence suggests that a reduction of high payroll taxes and a shift of some expenditure to general taxation should be considered. At the same time, expenditure on active labour market policies varies dramatically across the region and in many countries there is a pressing need to establish more effective public employment services, in addition to wider access for jobseekers and workers with obsolete skills, and threatened by unemployment, to training and other active labour market policies, as discussed below.

Increasing flexibility in the organization of working time

Enterprises are increasingly relying on various types of working time patterns that permit greater flexibility in working hours over a day, week, month or even an entire year. In the past, such "flexibility" in the organization of working time had been limited mainly to overtime work and shift work in its various forms. However, in recent decades there has been a marked trend away from the traditional "standard workweek" towards a more diverse array of options for arranging any given number of working hours. Although this trend is gradual, it is nonetheless quite real: in 1995, some 65 per cent of workers in the EU had fixed work schedules, but by 2005 this figure had decreased to 61 per cent. Often, but certainly not always, flexible working arrangements have adverse consequences for family life and local communities.

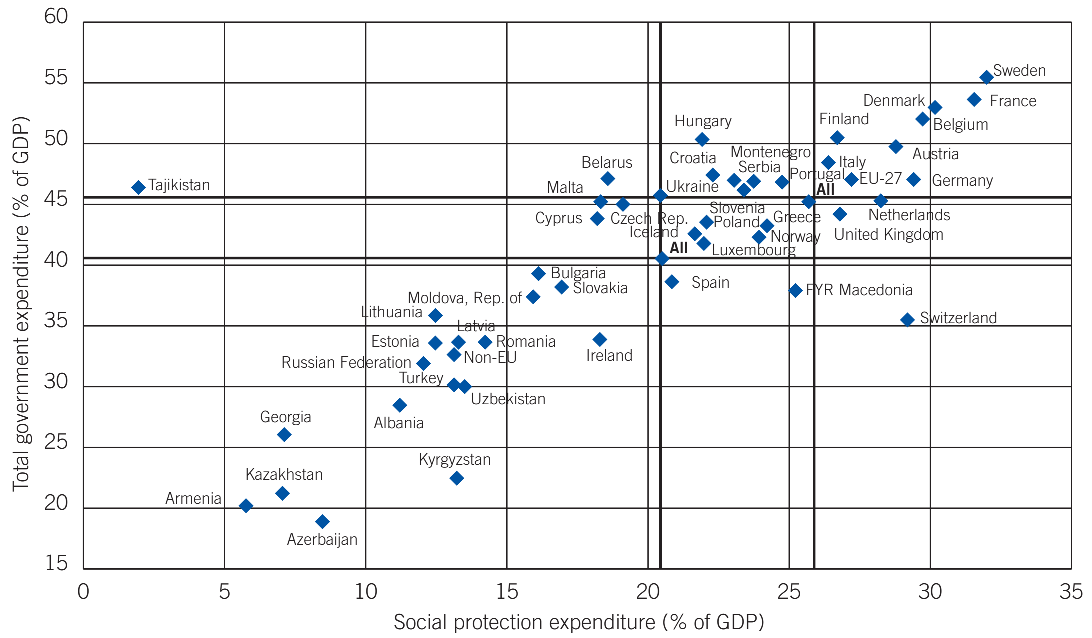
It is possible that the expansion of weekend and night work could be a factor, albeit minor, contributing to the observed productivity trends in EU-15 countries. Certainly, the extension of non-traditional working hours would normally allow the existing capital stock and facilities of an enterprise to be used more intensively. This would be reflected in a decline in the capital/labour ratio. It is also plausible that the additional output generated by longer working hours does not match that achieved during the traditional workweek, thus diminishing the observed productivity trends.

The way in which working hours are organized at the workplace can have a significant impact on both conditions of work and enterprise competitiveness. Consequently, work schedules are needed that offer possibilities to accommodate the needs of individual workers, including their family responsibilities, and simultaneously meet the business requirements of enterprises. If properly structured, flexible work schedules can be mutually advantageous for both workers and enterprises, as they increase employee job satisfaction and improve their work–life balance, while simultaneously allowing employers to cope better with workload fluctuations and to reduce overtime costs. In particular, incentives should be offered to enterprises to adopt flexible working time arrangements, such as flexitime and working time accounts, which have been shown to improve employee morale and productivity, and can in turn improve enterprise competitiveness and quality and, ultimately, the firm's financial performance.

Diverging emphasis on social policy across the region

There is far more diversity even within the EU, in forms of social protection, than is commonly acknowledged. Indeed, the level of government expenditure on social protection varies dramatically across countries in the region (see figure 6). The average level of public expenditure on all social protection measures in the EU-27 is slightly above 27 per cent of GDP (including administration costs). But many of the new EU-12 countries, such as Estonia, Latvia, Lithuania and Romania, spend less than 15 per cent of GDP on social protection. Beyond the EU, there is even greater diversity, with several countries in Central Asia devoting less than 10 per cent of GDP to social protection.

Figure 6. Social security expenditure and total government expenditure (2005)



Note: Two figures are given for “All” (All countries). The higher figure is the average for all countries weighted by GDP and the lower figure is weighted by population.

Source: ILO calculations based on data from the ILO Social Security Inquiry database, Eurostat, the Organisation for Economic Co-operation and Development, the Asian Development Bank and the International Monetary Fund.

Figure 6 also depicts a strong positive correlation between the overall magnitude of government expenditure and the level of social security spending. On average, countries spend about half of their total fiscal budgets on social protection. There are exceptions, however. Switzerland combines low taxes and a relatively low level of total government expenditure with high spending on social protection. This demonstrates that if the political will exists it is possible for countries to invest a greater concentration of available tax revenue in social policies than is commonly the case.

The differences in social protection expenditure levels across countries result in vastly different proportions of the population being covered by social protection, as well as major differences in the real value of cash benefits and the quality of social services. The variation in expenditure levels across the region largely reflects different attitudes to income redistribution and the ability of governments to collect taxes and contributions, which are necessary to finance social policies.

Surprisingly, the divergence across the region appears to be increasing over time. Since 2000, those countries within the EU-27 with relatively low social expenditure have tended to decrease even further the proportion of GDP that they allocate to social policy. In comparison, countries that already spend large shares of their GDP on social protection have maintained or slightly increased this ratio. It was suggested above that there is emerging evidence of "economic convergence" across the region. It would appear that this is not reflected in what might be termed "social expenditure convergence."

Financing increased social protection expenditure in lower income countries is challenging but possible. It may require a judicious mixture of domestic tax reform to raise additional revenue, plus some further international or regional support.

A group of eight countries – Austria, Belgium, Denmark, France, Germany, Netherlands, Sweden and Switzerland – exceed the average EU expenditure on social protection. Among this list of relatively "high" spenders are countries with longstanding and impressive economic and employment performance records, as well as others with less positive results. Thus, assertions of a simplistic negative trade-off between economic performance and social expenditure levels do not hold up to scrutiny. Countries should therefore have substantial policy space when shaping their social protection schemes.

There is also significant divergence in how countries in the region allocate their aggregate social expenditure. Figure 7 shows the proportion of total social protection expenditure devoted to health and pensions in the EU-27 and other countries for which data is available. It is clear that in all these countries social expenditure is heavily dominated by spending on pensions and health care. This also appears to be the case in lower income non-EU countries (not included in figure 7).

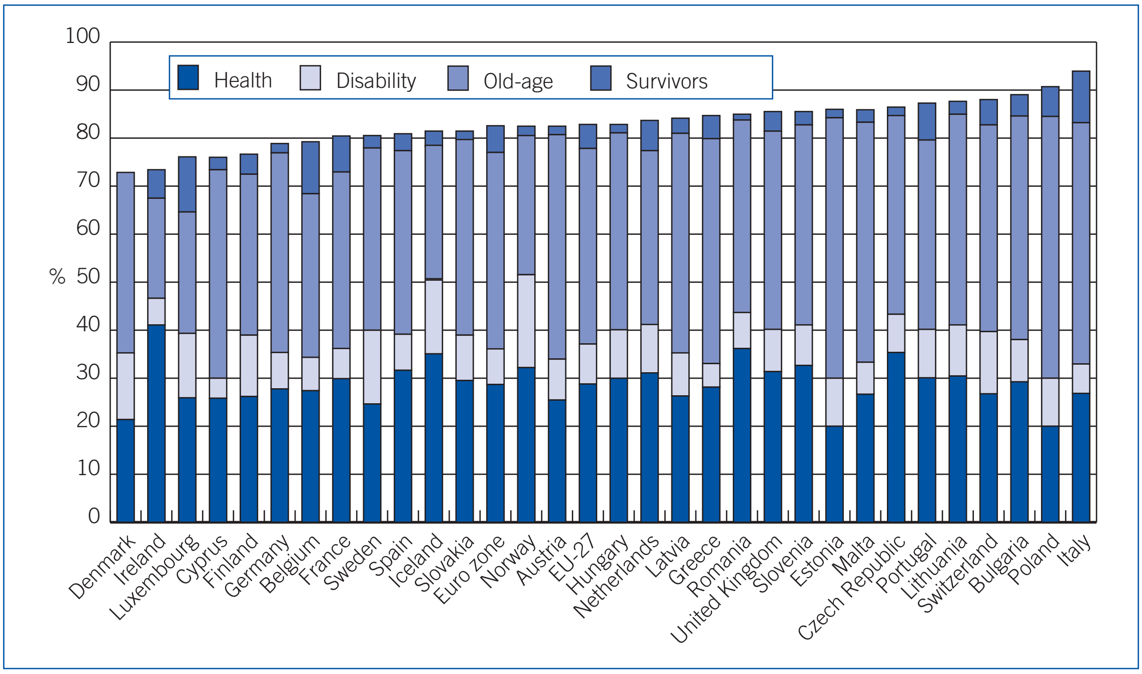
Italy allocates over 90 per cent of total social expenditure to pensions and health care. At the other end of the scale, Denmark devotes just over 70 per cent of resources to these two branches of social protection.

One major reason for concern about the overall cost of social protection has been the trend towards ageing populations and the burden that this will place on future generations. On the positive side, demographic trends in the region might provide scope for an increase in migration. However, this is unlikely to be a sufficient response. Consequently, increased attention is also being paid to raising labour force participation rates among the existing adult population, as well as to boosting productivity. This in turn depends upon creating jobs for older workers, improvements in health and safety conditions to ensure workers remain capable of working longer and convincing employers to hire older workers.

The Economic Policy Committee of the EU has produced cost projections of ageing populations on the most important social security benefits. Table 3 displays the latest available forecast, which suggests sizeable cost increases in the areas of pensions and health care, with some savings derived from education expenditure and unemployment benefits.

Overall, the EU is projecting the need for an increase in public expenditure on pensions of 2.2 points of GDP by 2050, with health-care costs increasing by an additional 1.6 points. These are substantial increases, but more modest than was expected just a few years ago. Back in 2000, the expected increase in pension expenditure was around 8 points

Figure 7. Share of expenditure on health services and pensions as a percentage of total expenditure on social protection (EU-27+3)



Note: "Health" comprises health services and sickness benefits, as well as disability measures; "pensions" comprises old-age (retirement) pensions, pensions paid to survivors (widows, widowers, orphans) and disability pensions.
Source: Eurostat; ILO.

Table 3. Projected changes in age-related public expenditure (EU-27,* 2004–50)

		Change from 2004 in percentage points to:	
	Level in 2004 (% GDP)	2030	2050
Pensions	10.6	+1.3	+2.2
Health care	6.4	+1.0	+1.6
Long-term care	0.9	+0.2	+0.6
Unemployment benefits	0.9	-0.3	-0.3
Education	4.6	-0.7	-0.6
Total	23.4	+1.6	+3.4

* excluding Bulgaria and Romania.
Source: The impact of ageing on public expenditure: Projections for the EU-25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004–50), European Economy, Special Report No. 1/2006 (Brussels, 2006), p. 11.

of GDP, or nearly four times what is now being projected. The differences can be explained by the progress that has been made in raising employment rates and retirement ages, while also reducing pension replacement rates since the beginning of the new millennium.

Countries have a limited number of options available to them. These include moving even further in the direction that policy has taken in recent years by implementing additional increases in retirement ages and reductions in effective pension levels.

A necessary complement are measures for boosting productivity and economic growth. As noted above, labour productivity growth has slowed considerably in the EU-15 over the past decade and lags well behind the productivity levels being achieved in other advanced countries, such as the United States and Japan. Thus if, for example, in the EU-15 average annual productivity growth could be boosted from the 1.2 per cent level achieved between 2000 and 2007 back to the 2.2 per cent rate that prevailed between 1987 and 1995, without sacrificing gains made in augmenting employment rates, fears about the impact of demographic changes on the cost of social protection would diminish dramatically.

Need for stronger labour market policies to improve a flexibility–security balance

Part of the explanation for the slowdown in EU-15 productivity growth may be a significant increase in atypical forms of employment, which tend to be less productive because of lower skill requirements and the lower access of such workers to training and skills development, as well as lower motivation to contribute to productivity improvements in the firm.

Part of the required response must emerge at the enterprise level. There is an understandable reluctance for enterprises to invest in skills training for workers who are only expected to remain in the firm for a limited period. This is why past studies have found a positive relationship between job tenure, investment in training and productivity levels. Employers also tend to discriminate against older workers on the grounds of their alleged lower productivity. To avoid this assumed trade-off between rising employment rates for older workers and lower productivity, policies are required to ensure that older workers remain healthy throughout their working lives and have continuing access to training and skills development. Given that much of the improvement in employment rates is explained by increases in temporary and part-time work, the incentive to expand firm-level training for such workers is limited. But public policy can play an important role in augmenting the incentive structure, for example through training levy/subsidy schemes and tax breaks for firms that meet training targets.

This leads to a discussion on active labour market policies as a significant factor in improving both employment and labour productivity levels, as mentioned earlier. It naturally follows from the data presented in figure 7 on pensions and health expenditure that the resources countries allocate to other branches of social protection must also vary significantly. These include public expenditure on unemployment benefits and active labour market policies. Denmark and the Netherlands are well known as the countries that have led the field in the development of so-called "flexicurity" arrangements. These arrangements entail very high levels of expenditure on both unemployment benefits and active labour market policies.

High public expenditure on unemployment benefits and active labour market policies provides income security for the unemployed and enhances the probability of rapid re-employment for workers who lose their jobs. This is seen as a substitute for reduced employment security in existing jobs. This environment provides encouragement for workers and employers to embrace structural changes that increase national productivity and prosperity.

Significant reforms have been made to employment protection legislation to enhance the flexibility of labour markets, and also to unemployment benefit schemes. Reforms have rightly focused on making unemployed persons more active by demanding greater proof of job search and participation in training, retraining and skills upgrading, job placements or other programmes designed to increase employability and implement the concept of lifelong learning. However, to make these programmes effective and ensure that they contribute significantly to reducing unemployment, overcoming skills mismatches and increasing productivity, their funding must increase substantially.

Unemployment benefit replacement rates vary significantly across the region. The highest replacement rates are in Denmark, France, Netherlands and Sweden. This list includes the classic flexicurity countries. At the other end of the spectrum within the EU are Hungary, Ireland, Italy and United Kingdom.

The debate and policy reforms related to flexicurity have not paid sufficient attention to the security of those in the most flexible jobs: those working part time or under temporary and casual employment contracts. As mentioned previously, workers in these atypical forms of employment require improved access to pensions, other non-wage benefits and employment rights. In many countries in the region, workers in such situations are not granted access to the national pension system. In other cases, the pensions that these workers can expect to receive in retirement are inadequate and well below poverty thresholds. Similar problems exist for workers who leave the labour market for several years to care for children or family members. In Denmark and Sweden, however, workers taking a career break to care for children do not encounter major penalties in the pensions that they can expect in retirement. This approach, also practised in a number of new EU Member States, should also be considered by policy-makers in other countries in the region.

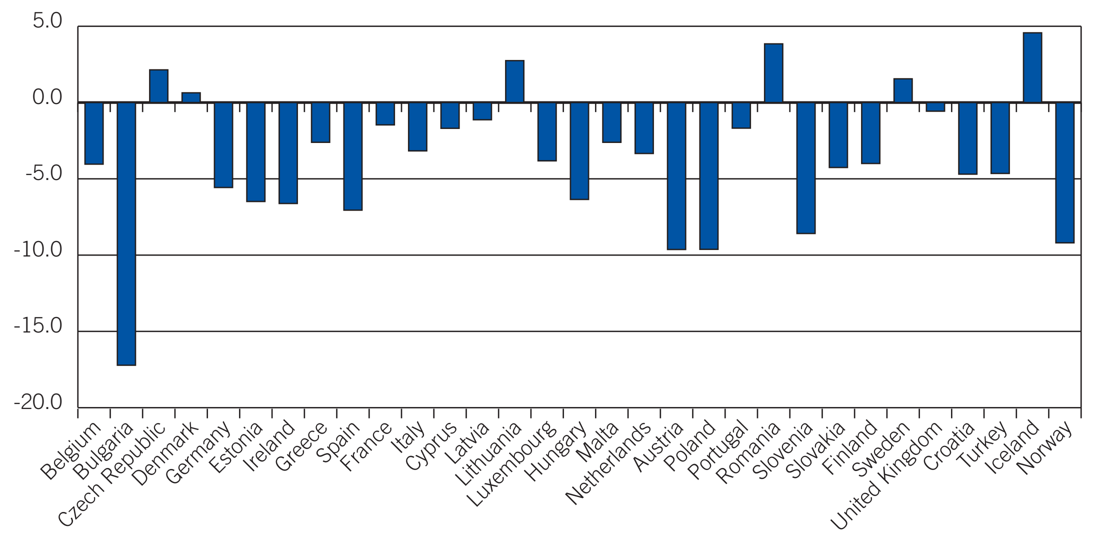
Declining wage share of GDP and widening income disparities

Many countries, particularly in the EU-15, have experienced several years of real wage restraint despite reasonable economic growth and tightening labour markets. For example, over the decade 1996–2006, real average wages fell marginally in Spain and increased very moderately in Austria, France, Germany, Italy and Portugal. In the vast majority of countries, real wages have not increased in line with productivity improvements or the rate of economic growth. When this happens, workers receive a declining share of the total economic "pie", which is reflected in a falling wage share (that is the share of employee compensation in total GDP) and rising profit levels.

For the EU-27 as a whole, the wage share of GDP declined from 59.6 per cent in 1995 to 57.1 per cent in 2007. This decline was particularly steep in the euro zone, where the wage share fell from 59.4 to 55.8 per cent over this period. Moreover, the decline accelerated following the establishment of the Economic and Monetary Union and EU enlargement.

Figure 8 shows trends in the wage share for those countries for which data is available. In the period since 1995, the wage share has declined in 24 countries, while increasing in just seven. For example, in Bulgaria the wage share has fallen by a massive 15 per cent over this period, while in Austria, Norway, Poland and Slovenia the decline has been close to 10 per cent. Very significant declines have also been experienced in Estonia, Germany, Hungary, Ireland and Spain. On the other hand, the wage share has increased in the Czech Republic, Denmark, Iceland, Lithuania, Romania and Sweden. It has remained more or less stable in the United Kingdom.

Figure 8. Changes in the wage share of GDP (1996–2007)



Source: Annual macroeconomic database of the European Commission's Directorate General for Economic and Financial Affairs (AMECO).

Comparable wage share data for countries outside the EU is not available. To help rectify this shortcoming, the ILO has recently prepared estimates of the wage share in developing countries based on the United Nations National Accounts Statistics, including estimates for a number of CIS countries. This analysis compared the change in the wage share for two periods: 1995–2000 and 2001–07. Research revealed a dramatic decline in the wage share in Kyrgyzstan and Kazakhstan and more moderate declines in Armenia, Ukraine, The former Yugoslav Republic of Macedonia and Russian Federation.[13] Two CIS countries, Belarus and Azerbaijan, show an increase in the wage share.

The general trend towards a declining wage share in the CIS countries emerged despite the fact that real wages have been increasing very rapidly in most of these countries since 2001. It would therefore appear that in much of the subregion labour productivity has increased even faster than real wages.

Similar trends can be seen in many of the EU-12 countries, where real wages have been increasing since the second half of the 1990s. In both the former transition countries of the EU-12 and the CIS countries, this recent experience has represented a period of catching-up after massive real wage declines during the first half of the 1990s. But, as observed previously, this coincided with a period of strong productivity growth. For example, average annual productivity growth rates in Estonia, Latvia and Lithuania were close to 7 per cent over the period 2000–07, and all the other EU-12 former transition countries (except Hungary) have recorded annual productivity improvements of between 3 and 5 per cent since 2000. Consequently, for most of these countries labour productivity growth has continued to exceed increases in real wages, leading to a decline in real unit labour costs and the wage share.

The emergence of significant real wage pressures in the former transition countries of the EU-12 and the CIS has not therefore disrupted the trend towards economic convergence discussed previously. In fact, for the EU-12 as a whole, annual average productivity growth accelerated after 2000. There is no evidence so far at the aggregate level that higher real wages are deterring the transfer of technology. Indeed, it could be argued that the pickup in real wages is acting as a "hard wages constraint" and a spur to productivity improvements, since it encourages enterprises to continue upgrading their technology to retain their competitive edge.

It could also be argued that real wage restraint, as reflected in the declining wage share in the EU-15 countries, has reduced the incentive for capital–labour substitution and may have been a factor behind the decline in capital deepening since 1995. Spain may be a case in point, since real wages actually declined over the period 1996–2006, which was matched by negative productivity trends over the same period. Italy is another example, with real wages declining on average by 0.3 per cent a year over the period 1993–2006. Among the EU-15 countries, Italy has witnessed the second slowest productivity growth in the last decade or so (the slowest has been in Spain). As indicated in table 2, the Mediterranean countries (Greece, Italy and Spain) recorded a negative trend in total factor productivity over the period 1995–2004.

Concern has also been expressed about widening wage differentials within countries and the deterioration in the relative income position of unskilled and semi-skilled workers across the region. As might be expected, the growth of wage disparity has been particularly rapid in countries that went through a political and economic transition, as wage differentials were minor during the Soviet era. In the Russian Federation, where income inequality is

[13] ILO: *Global Wage Report 2008/09: Minimum wages and collective bargaining: Towards policy coherence* (Geneva, 2008).

the highest among the CIS countries, the difference between the best paying sector (finance) and the one paying the least increased from four times in 1995 to seven times in 2007. Indeed, all Central and Eastern European countries have experienced widening wage differentials.

The gap between low and high wage earners has also increased in several EU-15 countries over the past ten years. In many countries, the sharp increase in the remuneration of the top 1 per cent of wage earners has been sharply criticized. In Germany, Chancellor Angela Merkel has claimed in the last year that dramatic increases in the earnings of top executives could "jeopardize social cohesion". This has initiated a debate in the country about how to limit excessive salaries of managers. In France, the remuneration of the CAC-40 top executives leaped by 58 per cent on average in 2007, inflated by the exercise of stock options. Similar increases in the remuneration packages of senior executives have been recorded in the Netherlands. These trends have shocked public opinion, and several European governments have recently reacted with severe tax penalties, while others are contemplating similar measures. [14]

Widening regional income gaps have also become a topical issue, especially in large countries. This undoubtedly represents a major concern in CIS countries. In the Russian Federation, regional location represented the main factor explaining wage differentials, with a difference of more than seven times between the most and least developed regions in 2006. Regional differences have also increased in small countries, including Croatia, Czech Republic and Hungary.

Some progress has been made in reducing the gender wage gap, but many observers point out that this is because male wage adjustments have been inadequate, rather than due to a substantial and pronounced pickup in female wage levels.

Working poverty remains another important issue in several countries within the EU-27, which probably explains why there is renewed interest and importance attached to minimum wage fixing systems in several countries. One reason for this is that the minimum wage remains low in many countries, notwithstanding the fact that it has been increasing substantially in recent years in most. The situation of low wages is particularly acute in CIS countries, where wage differentials have also widened over the years.

The persistent problem of the non-payment of wages remains prevalent in parts of Central Asia and South-Eastern and Eastern Europe.

It is important to note that many of the above concerns are reflected in the ILO Declaration on Social Justice for a Fair Globalization, which calls for "policies in regard to wages and earnings … designed to ensure a just share of the fruits of progress to all and a minimum living wage to all employed and in need of such protection".

[14] J. Thorhill, R. Milne and M. Steen: "Accent on égalité: Europe loses patience with its wealthy elite", in *Financial Times,* FT.com, 8 June 2008.

Renewed emphasis on social dialogue for finding the right policy mix

The region is clearly marked by very diverse trends across subregions and countries, and even between groups within countries. One of the more positive trends is the initial indication of economic convergence in the region. Increased labour force participation and employment rates in several countries are another, particularly among women and older workers. Yet for much of the region, employment levels remain inadequate and many of the new jobs created are atypical and precarious. Rising inequality within countries is also a matter of concern. These issues warrant careful reflection as participants discuss how they plan to translate the recent ILO Declaration on Social Justice for a Fair Globalization into practice in the region.

There are perhaps two overriding economic developments that will significantly influence the prospects for decent work and social justice in the region in the period ahead. First, attention will focus on the immediate global economic environment. As noted previously, economic growth in parts of the region, particularly in the EU-15, has slowed dramatically. Simultaneously, inflationary pressures have re-emerged.

In the face of rapidly mounting energy and food prices, there are concerns about upward pressure on nominal wage adjustments, and that the subsequent inflationary expectations could lead to a price–wage spiral similar to that experienced after the oil price shocks in the 1970s and 1980s. After a decade in which real wages have failed to keep pace with productivity improvements, there are mounting pressures for catch-up wage claims. Low-income families have to devote a large proportion of their incomes to the items that have become much more expensive in the past year: food and fuel. In some countries, such as Spain and the United Kingdom, where working families have seen their notional wealth reduced by declining house prices in the past year, there will be additional pressure for wage increases to restore savings.

The fact that real wage restraint in the recent past was accompanied by record levels of corporate profits and a rapid growth in salaries, share options and bonuses paid to executives, has important implications for perceptions of fairness. Indeed, workers in many countries feel that they have shouldered far more than their fair share of the anti-inflationary burden over the past decade.

Given that wage outcomes and collective bargaining are at the core of concerns about future inflation, these are clearly matters that labour ministries, trade unions and employers' associations can influence.

The opportunity must be seized to place full employment and decent work at the centre of economic policy debates and discussions about remuneration. The introduction of more coordinated collective bargaining which provides greater scope to take into account the public interest and broad economic developments would be desirable in the present circumstances. This would also be the best way of moderating the dramatic expansion of wage and income differentials that we have witnessed in the past and of promoting greater social cohesion.

Europe and Central Asia have a rich history of social dialogue, particularly in many of the EU-15 countries. Formal institutions for social and economic dialogue already exist in several European countries. At their best, these forums facilitate the sharing of information between the government and the social partners, as well as consultations over policy options. This can lead to consensus about critical policy decisions and shared responsibility between the government and the social partners for the implementation of decisions, which provides the EU, in particular, with a major untapped comparative advantage. Over the past two decades, the scope of, and reliance on, social dialogue in the subregion has fluctuated. Generally speaking, social dialogue remains important for many labour market and social issues. But tripartite consultations over wider economic issues have become less frequent and less important.

Meanwhile, attempts have been made to spread the EU-15 experience of social dialogue and the necessary institutions more broadly throughout the region. Success on this front has been mixed. Serious problems with freedom of association and the right to collective bargaining remain in the region, as indicated elsewhere in this Report.

Now is the time to re-energize and utilize more fully the institutions and experience of social dialogue to help cope with the emerging economic challenges. A far greater degree of social dialogue is required on the current economic environment and the need for a policy mix that produces sustained economic growth and better jobs. By involving employers' and workers' organizations in dialogue about the current economic outlook and the policy options available, governments can maximize their chances of securing support for a non-inflationary fiscal stimulus. In this environment, social dialogue might lead to important compromises. For example, tax reforms that raise the disposable income of the low paid, plus increased expenditure on job-creating infrastructure projects and social policies, might be discussed as compensation for more moderate wage adjustments.

To be successful, social dialogue on economic policy should not be seen as an isolated attempt to win the support of workers and employers in a period of economic trouble, but as a signal that economic policy determination will be altered and made more inclusive on a permanent basis.

The second overriding economic development that will influence the prospects for decent work in the future is more long term and relates to the divergent productivity developments discussed above. As seen earlier, relatively rapid productivity growth in the non EU-15 countries has helped economic convergence across the region. This trend towards economic catching-up is in its very early stages and could easily be reversed. To maintain and accelerate the pace of economic convergence, it is important to preserve open economies and facilitate technological transfers. It is equally important to ensure that economic progress in the non EU-15 countries is reflected in commensurate social progress.

The analysis in this Report has also shown that the EU-15 countries have faced a trade-off between employment and productivity goals over the past decade. The slowdown in EU labour productivity growth since the mid-1990s is a significant cause for concern. So far the EU-15 economies have not managed to mobilize the longer term mechanisms that would allow the achievement of both the employment and productivity goals of the Lisbon Strategy.

To maintain recent trends that have seen rising employment rates in general, and those of women, immigrant and older workers in particular, and at the same time improve the quality of employment and accelerate productivity, will require greater commitment and more resources for education, skills development, labour market policies, and social dialogue and collective bargaining. Getting the balance right is critical if the dual Lisbon Strategy objectives of higher employment and productivity are to be achieved. The Decent Work Agenda offers a practical platform to achieve this goal.

Appendix

Labour productivity growth (GDP per hour, annual average, %)

	1987–95	1995–2007	2000–07	2005	2006	2007
European Union (EU-15)	2.2	1.4	1.2	1.0	1.5	1.3
Austria	2.8	2.3	1.4	-0.4	2.3	2.7
Belgium	2.2	1.4	0.9	-1.2	1.5	1.3
Denmark	2.6	1.0	0.8	1.3	0.9	-0.3
Finland	3.2	2.5	2.3	1.9	3.2	2.6
France	2.2	1.7	1.3	1.8	0.9	0.6
Germany	2.5	1.7	1.4	1.5	2.4	1.0
Greece	0.8	2.4	3.1	2.9	3.0	2.4
Ireland	2.4	3.7	2.5	0.5	1.5	2.3
Italy	2.1	0.6	0.3	0.4	1.0	1.0
Luxembourg	2.0	1.6	0.9	2.0	0.2	0.6
Netherlands	1.8	1.4	1.2	1.8	0.0	0.7
Portugal	1.6	1.7	0.3	1.1	0.2	1.5
Spain	2.3	-0.2	0.0	-0.3	0.1	0.6
Sweden	1.1	2.5	2.6	3.4	2.9	1.3
United Kingdom	2.0	2.2	2.3	1.0	2.4	2.9
European Union (EU-12)	–	3.9	4.4	2.7	4.1	3.5
Bulgaria		1.7	3.5	3.8	3.3	4.0
Cyprus	–	1.0	0.3	1.5	2.2	2.2
Czech Republic	–	3.4	4.4	4.4	4.6	4.5
Estonia	–	7.1	6.6	7.2	5.4	6.6
Hungary	–	2.3	2.2	4.3	3.4	2.1
Latvia	–	6.6	7.1	8.0	7.3	8.2
Lithuania	–	5.7	6.6	1.9	6.7	6.2
Malta	–	1.3	0.7	1.0	2.5	1.8
Poland	–	4.2	3.3	0.7	3.1	1.9
Romania		4.0	7.4	3.1	5.2	4.7
Slovakia	–	5.1	5.1	2.4	6.5	6.3
Slovenia	–	4.2	3.9	4.0	4.5	3.8
European Union (EU-27)	–	1.8	1.6	1.0	1.7	1.4

Source: The Conference Board and Groningen Growth and Development Centre, Total Economy Database.