Informal Ministerial Meeting of the EU Accession Countries

Decent Work and Competitiveness Labour dimensions of accession to the European Union Movement of Labour

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Introduction

This note examines briefly the employment and labour dimensions of accession to the European Union in 13 candidate countries. It reviews the employment and labour implications of accelerated economic growth and rising real incomes through structural adjustment and reform, a process of real convergence with EU income and welfare levels. It also examines the implications of what is termed nominal convergence or sustained non-inflationary growth within the Maastricht criteria of countries preparing to join the European Monetary Union (EMU). The compatibility of real and nominal convergence is discussed. The note makes an argument for employment and labour as central policy issues in the process of convergence. For both economic and social reasons, the level of employment, the productivity of labour and the level of social welfare represent critical dimensions of the process of convergence. In particular, competitiveness in accession countries is highly influenced by the level of labour productivity. Rising levels of labour productivity require a set of policies that promote stability, cooperation and training, rather than insecurity and low wages. Policies that combine rights at work, employment, social protection and social dialogue, that is policies for decent work, stand a better chance of promoting an environment conducive to sustained rises in labour productivity. There is a need to re-examine the importance accorded to employment and labour policies, including as regards financing of these policies, through either domestic or EU means.

1. Background to enlargement of the EU membership

The European Union is committed to enlarging its current membership of 15 countries. A number of countries are currently in the process of negotiations to be members of the European Union in the next few years. The principles and conditions of membership in the EU have been defined at the Copenhagen European Council (1993) and further detailed in subsequent European Councils (Nice, 2000 and Göteborg and Laeken in 2001). Future members are required to establish their capacity to assume the full responsibilities of membership, including adherence to the aims of political, economic and monetary union. Candidate countries are required to harmonize their internal laws and regulations with those of the European Union in all areas covered by the European Union Treaty.

Beyond adherence to the political aims of the European Union, accession is a means for candidate countries to converge with European levels of income and standards of living. Average per capita income in 2000 among the 13 countries was 44.8 per cent of the EU-15 level, with significant disparities among the candidate countries (Figure 1). Membership can bring clear advantages in terms of a more stable institutional environment, reduced transaction costs and greater trade linkages. This could further foster a conducive environment for investment, in particular of foreign origin, and

contribute to faster economic growth as well as social development, enabling these countries to rapidly raise living standards and converge towards EU-15 levels. Employment levels, working conditions and social protection could stand to gain from rapid convergence.

At the same time, there are significant threats that cannot be underestimated. Membership in the European Union implies joining a trade and economic union. In principle, there should be free movement of goods, services, capital and persons. In practice however, discussions are on-going regarding the free movement of workers. In addition, transition periods of various durations are being considered for different products in which accession countries have a clear comparative advantage (for instance, in agriculture or steel). Important negotiations are under way in these areas the implications of which for employment and welfare cannot be underestimated.

Accession countries are required to incorporate into their respective national legislation the EU legislation (or acquis communautaire) divided into 31 chapters ranging the full span of economic, social and judiciary regulations. Such legislation includes the fundamental principles and rights at work defined by the ILO as well as many other aspects covered by ILO labour standards.

Membership in the EU does not automatically imply joining the European Monetary Union (EMU). Candidate countries are expected to follow the same procedure leading to the formation of the EMU and hence conform to the Maastricht criteria for some time before. In particular, prior to joining the monetary union, a country must be able to sustain a high degree of nominal convergence with the euro area, in particular as regards price stability. A first step will be for countries to join the exchange rate mechanism (ERM-2) whereby the European Central Bank and the relevant national central bank jointly adjust central rates within a central band of fluctuation of -/+ 15 per cent. A candidate country is expected to have remained within the ERM-2 for at least two years prior to joining the EMU. Various exchange rate arrangements are compatible with the ERM-2.

2. Employment and labour implications of real convergence.

One of the defining characteristics of an economic and monetary union is the strengthening of trade linkages as both an engine and consequence of integration. Candidate countries already direct over half of their exports to the EU (51.7 per cent on average in 2000, with a low of 33.5 per cent for Malta and a high of 76.5 per cent for Estonia) and obtain 55.5 per cent of their imports from the EU (European Commission, 2001). Closer trade integration has accelerated as a result of the structural transformation many of these countries underwent as of 1989, in particular trade and capital liberalization. Negotiations over accession to the EU have no doubt further accelerated such trends. First by reducing estimates of risk on future investment as a result of possible entry into the EU, second by enhancing the attractiveness of closer trade integration. In particular proximity to the EU market, lower relative labour costs and a well-educated labour force have been and remain strong arguments for foreign direct investment.

Labour cost differentials

One reason for closer trade integration between accession countries and the EU is based on different relative factor endowments, as seen for instance in the relative labour costs between the EU and the accession countries. ILO data suggest that on average labour costs in manufacturing in the accession countries for the last years of the 1990´s are on average less than 10 per cent of the highest labour cost country of the EU, namely Germany with a range from 4 to 22 per cent in 1998 (Table 1).

Table 1: Labour cost in manufacturing (in US$ per hour)

	1995	1996	1997	1998	1999	2000
Czech Republic	2.96	3.33	3.16	3.44	3.40	
Estonia	2.00	2.38				
Germany	35.27	34.75	30.79	30.96	26.68	32.00
Hungary	3.77	3.60	3.42	3.46	3.49	3.38
Latvia			2.01			
Lithuania		1.63				
Poland		2.86	2.95	3.21	3.22	
Romania	1.21	1.25	1.06	1.30	1.16	
Slovakia		2.80	2.85	3.17	2.76	
Slovenia	6.77	6.77	6.43	6.83		
Turkey	2.99	2.94				

Source: ILO Yearbook of Labour Statistics and IMF International Financial Statistics.

It is possible that labour cost difference will gradually narrow as a result of greater trade integration. Real wages (total economy) have increased between 1995 and 2000 in 8 out of 10 countries for which data are available at an average rate of 3.9 per cent per year (Table 2). The pace of real wage increase is likely to remain sustained, for a variety of reasons, as a result of closer integration with the EU. The very low initial level of wages, that have fallen further in the 1990-94 period in many countries, should not be forgotten. It is impossible to say how long labour cost convergence will take if at all, save to observe that substantial differences continue to prevail within the current EU-15, in spite of over 20 years of close integration.

Table 2: Trends in real wages in total economy (1995=100)

	1995	1996	1997	1998	1999	2000	2001
Bulgaria	100	81.10	72.10	79.44	86.69	90.47	94.36
Czech Republic	100	108.09	111.99	111.50	116.47	120.06	121.82
Estonia	100	101.66	109.43	113.47	121.30	129.06	
Hungary	100	96.21	102.68	104.03	102.51	103.90	110.76
Latvia	100	95.42	101.44	109.15	116.77	122.41	
Lithuania	100	105.30	117.65	138.18	146.00	146.38	141.28
Poland	100	105.88	112.95	118.94	122.12	124.93	126.80
Romania	100	107.59	83.47	88.39	87.71	84.15	87.93

Slovakia	100	108.14	111.35	114.58	111.87	108.98	111.40
Slovenia	100	104.50	107.38	108.86	112.01	113.43	116.75
Source: UNECE							

Labour productivity

The performance of most accession countries in terms of labour productivity has been remarkable, particularly since 1995. Table 3 presents indices of labour productivity for 10 countries for the period 1995-2001. By 2000 labour productivity had increased on average by 33.3 per cent or an average annual increase of 5.9 per cent. Estonia, Hungary, Latvia, Poland and Slovakia have performed particularly well. In terms of levels of labour productivity or value added per person employed (in manufacturing) it is noteworthy that accession countries have reached levels ranging from 82 to 28 per cent of the EU-15 average in 1998, mainly but not only in foreign-investment enterprises (UNECE, 2001). The average annual growth in labour productivity in the sample countries has generally significantly exceeded the EU average. This clearly points to a process of catching up in which foreign investment plays a significant role as a catalyst for the transfer of new technology, production techniques and managerial know-how.

Table 3: Labour productivity index in industry (1995=100)

	1995	1996	1997	1998	1999	2000	2001
Bulgaria	100	106.36	100.09	96.01	95.95	113.61	
Czech Republic	100	102.85	107.87	111.37	111.46	120.61	
Estonia	100	107.60	130.81	138.96	142.85	156.06	167.66
Hungary	100	104.29	113.96	122.55	134.14	161.17	164.95

Latvia	100	111.77	122.93	137.96	136.19	139.56	
Lithuania	100	109.56	113.04	123.53	111.34	119.66	
Poland	100	109.07	121.30	126.88	141.84	161.04	
Romania	100	105.27	100.18	91.15	95.23	109.95	
Slovakia	100	102.49	105.92	114.65	114.58	129.30	
Slovenia	100	102.04	107.64	112.79	114.05	121.90	
Source: UNECE.							

A large part of the growth in labour productivity can be attributed to adjustment and restructuring as enterprises gradually adapt themselves to modern organization of production and technology. Countries have therefore experienced both rising levels of labour productivity and declining employment in manufacturing. Clearly, the challenge lying ahead is to sustain high growth in output per person whilst at the same time maintaining or even increasing levels of employment. The sectoral distribution of employment becomes an important issue here. Table 4 provides information on the percentage change in manufacturing employment in recent years. It is noteworthy that the share of employment in manufacturing remains significant in all countries and is not below 18 per cent save in Turkey. Too rapid a decline in manufacturing employment is not desirable.

Table 4: Employment in manufacturing

	As % of total employment	Average percentage change
	2000	1996-2000

Bulgaria	21.6	-5.37	1996-99
Czech Republic	27.1	-2.07	
Estonia	22.6	-2.80	
Hungary	24.2	2.29	
Latvia	17.7	-0.72	
Lithuania	17.9	-2.57	1997-2000
Poland	20.0	-1.88	
Romania	19.1	-4.91	
Slovakia	25.9	-2.41	
Slovenia	31.2	-3.00	1995-99
Turkey	14.1	1.40	1995-99
Source: Yearbook of Labour Statistics, ILO.			

Unit labour costs

The attractiveness of accession countries to foreign direct investment chiefly from EU-based enterprises does not lie only in low relative nominal wages per se, but rather lower unit labour costs. The labour cost of producing one unit is calculated as a ratio between the nominal wage (a proxy for labour cost paid by the employer) and labour productivity or output per person employed. Unit labour costs capture the change in the nominal wage in relation to the trend in labour productivity. Table 5 presents indices of unit labour costs in industry for 10 accession countries for the period 1995-2000. A decline (increase) in unit labour costs indicates an increase (decline) in the competitiveness of the country in manufacturing. An increase in unit labour costs can be due to either labour productivity falling behind nominal wage increases, or conversely wage increments outpacing changes in labour productivity. Excluding Bulgaria and Romania whose costs have increase precipitously as a result of high inflation, the remaining 8 countries register a steady rise in unit labour costs of 41 per cent on average over 1995-2000, or 7.1 per cent per year on average. The basic reason behind this increase is that nominal wages have risen faster than productivity growth. This is partly due to the fact that wages started from a low initial level and a process of catching up in real terms is taking place. However, a moderate rise in unit labour costs, implying nominal wage growth approximately in line with labour productivity growth is essential to maintaining the comparative cost advantage of manufacturing in accession countries. Only countries with the capacity to achieve this will maintain their competitiveness and continue to sustain the level of investment and exports required for a high rate of aggregate economic growth.

Table 5: Unit labour costs in industry (1995=100)

	1995	1996	1997	1998	1999	2000	2001
Bulgaria	100	188.71	2167.62	2658.77	2807.09	2629.44	
Czech Republic	100	114.45	122.59	130.74	139.31	137.95	
Estonia	100	116.34	114.46	123.56	132.93	134.53	
Hungary	100	116.44	129.59	140.54	145.66	139.40	155.89
Latvia	100	107.64	116.15	121.13	140.31	157.64	
Lithuania	100	116.37	139.63	144.48	170.70	160.81	
Poland	100	115.80	124.97	137.30	133.86	130.75	

Romania	100	150.69	316.82	540.14	744.49	913.65	
Slovakia	100	111.91	118.34	120.07	129.62	125.37	
Slovenia	100	111.78	118.54	125.23	135.35	141.49	
Source: UNECE.							

Structural shifts in employment

Precisely as countries open to trade and specialize according to relative factor endowments, structural change in employment is to be expected, with the share in agriculture falling, the share in industry dropping to around 20 per cent and the share in services increasing. All candidate countries are in the midst of this structural transformation, and it is to be expected that accession and membership in the EU will tend to accelerate this change. Table 6 presents data on the distribution of employment by sectors for the years 1995 and 2000. A word of caution is required as table 6 only registers formal employment and ignores informal employment that could be significant in some sectors. Most countries conform to the expected pattern of declining employment in the primary and secondary sectors compensated by a rising share in services. However the differences among the countries are perhaps as striking as the pace of change in each of them. Bulgaria, Poland and Romania are still characterized by a relatively important agricultural sector. There is little doubt as to the direction of the overall historical pattern of change. However, it is the pace of structural transformation that is the important variable, as changes in the relative shares of employment need to be congruent with changes in the employment generating capacity of those sectors that are to absorb labour expelled from the declining sectors. Too rapid a pace of change might lead to unwarranted levels of unemployment. Conversely, too slow a pace could retain labour in low productivity occupations and hence unduly constrain productivity growth.

Table 6: Employment by sector (1995 and 2000)

	Agriculture		Industry		Services		
	1995	2000	1995	2000	1995	2000	
Bulgaria	24.4	26.6	32.6	29.1	43.0	44.3	1996-99

Special mention must be made of the agricultural sector. The potential for raising land and labour productivity in agriculture in accession countries is likely to be important. However this must be balanced against its capacity to retain labour or the capacity of other sectors to absorb labour expelled from agriculture. Not all labour expelled from agriculture, due to age and skill patterns, is likely to be easily accommodated in non-agricultural activities. The potential of rural non-farm activities should in this regard not be overlooked.

An appropriate pace of change, including at the regional level, will generally require public policy interventions. There is a clear role for public investment in creating conditions attractive for a balanced pattern and distribution of private investment. This will have a positive effect on employment, if employment lost in one sector or industry can be absorbed in others. The size distribution of enterprises is another important criteria, and hence the incentives to small and medium sized enterprises to establish themselves in those areas and sectors of activity in which more employment needs to be generated.

Skills and training

An important means of sustaining high labour productivity growth is continuous investment in training and skills upgrading of the workforce. Education and training are important dimensions of structural transformation, as a high level of skills represents an excellent basis for adapting to rapid change. The educational level (in terms of the average years of schooling) of the labour force in accession countries is relatively high, even compared to EU levels. This should provide a sound basis for investment in upgrading the skills of the workforce. No direct estimates of the level of expenditure in training are available. Two issues are commonly raised. First, enterprise-based training, whether on the job or enterprise provided has in many countries simply collapsed for financial reasons. Second, many of the vocational training institutions are training in skills or with techniques considered obsolete or in very low demand. In view of the rapid pace of technological change, possibly even more rapid in countries in the midst of a catching up process, an adequate supply of the right kind of skills is fundamental. Enterprises should be given incentives to invest in the training of their workers. On the other hand, public institutions should seek to cater to the skills requirements of a rapidly changing economy, including by providing information on recent trends in labour demand by type of skills. In particular, special efforts are undoubtedly required to retrain significant segments of the labour force that are to change occupations, refresh their learning or adapt to an entirely new work and technological environment. Clearly training is an area in which accession countries, as well as the EU could raise the level of expenditure and programmes.

The labour market implications of an adequate balance between demand and supply by type of skills are clear. Bottlenecks are likely to occur in a period of rapid structural change, thereby affecting the unemployment rate. One dimension of such bottlenecks is the share of long term unemployed. Close to half of all unemployed in ten candidate countries have been unemployed for over a year, both men and women (Table 7). The extent to which long-term unemployment is a reflection of low aggregate demand, a mismatch between the skills of the unemployed and the skills demanded by enterprises, or a consequence of incentives and social benefits that hinder job search are matters that need to be investigated. In view of the low level of average wages, there may be a significant degree of overlap between social benefits and the low-skilled wages reducing job search incentives. In general, the longer a person of working age and in the labour force stays out of active employment, the likelier that person faces an obsolescence of his/her skills. A decisive reduction in long-term unemployment must represent a priority for all candidate countries.

Table 7: Share of long-term unemployed in total unemployment (2000)

	Total	Male	Female
Bulgaria	53	52.9	53.1
Czech Republic	50	49.1	50.7
Estonia	47.3	48.2	46
Hungary	47.9	50.6	43.6
Latvia	55.9	56.2	55.5
Lithuania	52.4	55.9	47.3
Poland	44.6	40.2	48.6
Romania	49.2	50.2	48
Slovakia	54.7	54.5	54.8
Slovenia	62.7	64.9	60.3
Source: EUROSTAT.			

This provides a clear signal of the need to step up training opportunities for persons in unemployment for over a year. A mix of policies combining training opportunities with active counselling and information on job opportunities have proven quite effective in a number of European countries. The experience of some transition countries shows, however, that the above measures are often not sufficient and that long-term jobless persons can benefit more from a combination of temporary employment schemes (public works or subsidized employment) with on-the-job training, followed by regular job placement assistance.

There is an additional dimension here. Most candidate countries are witnessing rapid demographic change with an increase in the average age of the population and of the labour force, and hence in the relative share of the population aged 65 and more. The implication for the labour market is two-fold. Special attention must be given to upgrading the skills of the persons in employment aged 45 years and over, in order not to prematurely astray them from employment for reasons of skill obsolescence. The experience of more senior workers is a valuable asset that must be fully used by enterprises. Appropriate incentives to that effect could be considered. Likewise, the skills of the younger generation must be tuned to the requirements of the economy. This calls for constant adaptation of educational and vocational training programmes.

Aggregate growth and employment

As of 1995, most accession countries have entered into a cycle of rapid GDP growth. Table 8 presents indices of GDP growth for all 13 countries for the period 1995-2001. By 2001, only Bulgaria and Romania had not regained or surpassed the level of GDP of 1995. On average GDP increased by 25.6 per cent for those 11 countries with positive growth, or a solid 4.7 per cent on an average annual basis. This contrasts with 2.7 per cent per year for the Euro area as a whole. In principle the 2 percentage points differentials, if it were sustained over a long enough period of time, would point to a catching up with the EU. The large gap between GDP per capita levels in accession countries and the EU (Figure 1) may cast a shadow of doubt. This confirms an empirical finding of growth theories on convergence, in that the lower the initial level of real per capita GDP, the higher the predicted growth (Barro, 1997). However this convergence is only conditional on a set of characteristics and policies over which there is no agreement.

Table 8: Real GDP growth (1995=100)

	1995	1996	1997	1998	1999	2000	2001
Bulgaria	100	89.9	83.5	86.5	88.6	93.7	98.3
Cyprus	100	102.0	104.6	109.8	114.7	123.8	128.8
Czech Republic	100	104.3	103.5	102.3	101.9	104.8	108.7

It is generally believed that rapid growth requires some combination of rapid physical and human capital accumulation, appropriate incentives for research and development, investment in infrastructure, a regulatory framework whether for private property, financial systems or labour utilisation and an acceptable distribution of national income. Policies would need to be based on the characteristics of each country and seek to promote an environment conducive for the above elements to initiate and sustain a process of rapid growth. One lesson that can be derived from recent experience is that countries cannot expect for high growth to set in simply through low tariff barriers and invitations to foreign capital to invest in recently privatised assets. Economic growth requires a range of active economic and social policies.

One critical dimension is the employment effect of growth. Table 9 presents data on trends in total employment in 12 countries. Only two countries (Hungary and Slovenia) display employment levels for both men and women in 1999-2000 above those in 1995 (excluding Turkey from this count given the deep economic crisis that started in 1999). An additional three countries show some increase in female employment over 1995. Looking at simple averages for all countries, employment has neither decreased nor increased. One can readily observe that the positive economic growth rates have not (yet) translated into positive employment growth in most countries. This can be explained as seen above with regard to structural and industrial restructuring and adaptation to a market economy. In order for accession countries to adequately redistribute the benefits of growth, a pattern in which both real wages and employment can grow in parallel will be required. This is required for unemployment rates to fall, and for a wider participation in the benefits of growth. One clear implication is that more attention needs to be paid to the pattern of growth in order to render it more employment intensive. This calls for a better integration of economic, employment and labour policies.

Table 9: Total employment (1995=100)

			1995	1996	1997	1998	1999	2000
Bulgaria	Official estimates	Total	100	100.1	96.2	96.0	93.6	
Czech Republic	LFS	Male	100	99.9	99.2	98.0	95.8	95.7
		Female	100	99.4	97.9	96.1	94.8	94.4
Estonia	LFS	Male	100	98.0	99.0	96.6	92.3	91.7
		Female	100	98.9	98.6	98.6	95.0	93.9

Hungary	LFS	Male	100	99.4	99.7	99.6	102.6	103.6
		Female	100	98.9	98.4	101.6	104.9	106.0
Latvia	LFS	Male	100	98.0	102.3	103.6	100.0	95.5
		Female	100	100.6	106.6	103.5	103.6	103.7
Lithuania	LFS	Total	100	99.3	96.2	97.9	97.9	93.0
Malta	Administrative records	Male	100	100.1	99.9	99.7	99.5	
		Female	100	103.4	105.7	107.9	110.9	
Poland	LFS	Male	100	101.5	103.7	104.6	100.5	98.9
		Female	100	100.9	101.3	102.8	98.9	97.4
Romania	LFS	Male	100	99.2	99.6	97.7	96.2	95.8
		Female	100	96.7	98.4	96.8	97.1	97.4
Slovakia	LFS	Male	100	103.5	102.0	101.4	97.5	95.3
		Female	100	103.9	103.7	103.6	101.6	101.1

Slovenia	LFS	Male	100	98.9	101.9	103.0	101.9	
		Female	100	100.2	101.7	102.7	100.2	
Turkey	LFS	Male	100	101.8	102.6	104.0	101.2	
		Female	100	99.4	84.0	98.2	106.1	

Source: ILO Yearbook of Labour Statistics.

Table 10 shows that unemployment rates between 1995 and 1999-2000 have fallen in some countries but have increased in others. It is noteworthy that unemployment has increased in the more recent period as of 1998 following an initial decline between 1995 and 1997.

Table 10: Unemployment rates as measured by labour force surveys (in percentages)

	1995	1996	1997	1998	1999	2000
Bulgaria	16.5	14.2	14.4	14.1	15.7	16.4
Czech Republic	3.7	4.1	5.4	7.3	9.0	8.3
Cyprus	2.6	3.1	3.4	3.3	3.7	
Estonia	9.7	10.0	9.7	9.9	12.3	13.7
Hungary	10.2	9.9	8.7	7.8	7.0	6.4

Latvia	18.9	18.3	14.4	13.8	14.5	14.6
Lithuania	17.1	16.4	14.1	13.3	14.1	15.4
Malta	3.7	4.4	5.0	5.1	5.3	
Poland	13.3	12.3	11.2	10.5	13.9	16.1
Romania	8.0	6.7	6.0	6.3	6.8	7.1
Slovakia	13.1	11.3	11.8	12.5	16.2	18.6
Slovenia	7.4	7.3	7.1	7.7	7.4	
Turkey	6.6	5.8	6.9	6.2	7.3	

Note: Age periods may differ. Registered unemployment is recorded for Malta.
Source: Yearbook of Labour Statistics, ILO.

3. Employment and labour dimensions of nominal convergence

Nominal convergence between candidate countries and the EU refers to a period during which countries meet the nominal Maastricht criteria and gradually qualify for entry into the European monetary union. As such nominal convergence is only indirectly linked to membership in the EU, as it is expected that new member countries will eventually join the EMU. The central elements in nominal convergence and the gradual fulfilment of the Maastricht criteria are price stability and a low level of inflation. The key question posed by nominal convergence is whether a rate of growth of GDP sufficiently high to absorb available labour force is compatible with low and stable inflation.

Inflation has dropped significantly in most accession countries over the last 5 years. In 2001 seven countries had annual rates of consumer price inflation below 6 per cent per year, and four between 6 and 10 per cent. Only Romania and Turkey experienced double-digit inflation (Table 11). Excluding these two countries, the average increase in consumer prices in 2001 was 5.3 per cent, or slightly more than double the rate experienced in the EU. It is a

debated issue whether underlying inflation is currently on a sustainable path in accession countries. In a high inflation environment, above 20 per cent per year for instance, wage policy would seek primarily to maintain the purchasing power of the wage. This is what is observed in Romania. In a low inflation environment, basically at a one-digit rate of inflation, real wage increases will seek to match labour productivity increases in the most dynamic sectors, usually manufacturing. Such wage increases will inevitably spread to the rest of the economy, thereby raising underlying wage inflation.

Table 11: Average annual percentage change in consumer prices

	1999	2000	2001
Bulgaria	2.6	10.2	7.3
Cyprus	1.6	4.2	2.0
Czech Republic	2.1	3.9	4.7
Estonia	3.5	3.9	5.8
Hungary	10.1	9.9	9.2
Latvia	2.4	2.8	2.4
Lithuania	0.8	1.0	1.5
Malta	2.1	2.4	4.1
Poland	7.4	10.2	5.5
Romania	45.9	45.7	34.5

Macroeconomic effects of productivity and wage differentials

Large inter-sectoral productivity and wage differentials, between those sectors exposed to international trade (tradables) and those sheltered from international trade (non-tradables) can be observed in countries engaged in catching up with economically more advanced countries. This development (known as the Balassa-Samuelson effect) predicts that fast productivity growth in tradables will lead to rapid wage increases in the non-tradables sector as a result of wage equalization across the economy. Since productivity growth will be much slower in the non-tradables, this will unleash inflationary pressures leading to a real appreciation of the exchange rate. This real appreciation can be absorbed either through a nominal appreciation of the exchange rate, provided countries have the required flexibility to adjust their exchange rate, or through higher inflation. Both these options collide with the convergence criteria implying a rate of inflation aligned with the EU rate and a stable nominal exchange rate. On the basis of available data, accession countries are indeed experiencing real exchange rate appreciation (Table 12) of the order of 21 per cent on average over 1995-2000. In view of the considerable gap between GDP per capita levels in the EU and in accession countries, one might expect further real exchange rate appreciation as countries embark on rapid economic growth to bridge the gap. This is doubly problematic for accession countries, because of the importance of nominal convergence for future membership in the EMU, and because this will tend to appreciate unit labour costs in foreign currency terms. Future foreign investment prospects could be harmed in this way.

A practical illustration of the Balassa-Samuelson effect is the case of Ireland in early 2001 that was given a warning from the EU economic and financial council for its pro-cyclical policies in the face of a tight labour market and a sharp rise in inflation. Buoyant growth throughout the nineties in Ireland has put pressure on available labour supply, thereby fuelling higher wage demands. As a member of the EMU the only policy instruments available to Ireland are fiscal policy and incomes policy. An alternative option is to increase labour supply, either through raising the employment rates of women and older persons, or through labour migration. This is a situation in which accession countries could well find themselves in. The alternatives are either to adopt a contractionary fiscal stance, or to raise the level of labour supply. This is a good illustration of the close integration of macroeconomic policy and labour market policy, and how one or the other affects the economy.

Table 12: Real effective exchange rates (based on producer price index)

	1995	1996	1997	1998	1999	2000
Bulgaria	100	96.98	103.31	122.76	125.08	132.42
Czech Republic	100	107.32	105.26	111.37	109.88	110.77
Hungary	100	100.24	109.70	108.86	108.24	109.63

Poland	100	108.63	109.29	112.80	109.86	115.94
Romania	100	98.43	111.02	125.52	105.86	121.65
Slovakia	100	104.24	106.65	109.04	100.19	104.21
Slovenia	100	97.62	95.73	99.87	96.74	90.32
Estonia	100	115.64	116.97	123.63	122.76	121.13
Latvia	100	114.43	121.32	126.17	127.63	133.05
Lithuania	100	117.47	129.25	127.37	138.08	168.15
Source: UNECE.						

UNECE estimates a likely real exchange rate appreciation of 3 per cent per year (UNECE, 2001). Other authors however disagree with this analysis arguing that underlying inflation in accession countries is quite low, with actual rates of inflation much more linked to structural transformation and external shocks such as oil price increases (Arratibel et al., 2002).

4. Labour market implications of a parallel pursuit of real and nominal convergence

The position of the European Central Bank is that nominal and real convergence should be pursued in parallel. Both monetary policy and exchange rate policy should seek "to support the parallel pursuit of real and nominal convergence" (Padoa-Schioppa, 2002). Concretely, this implies a rate of economic growth compatible with the stability criteria of Maastricht allowing countries to qualify for the EMU. The argument of the ECB is that the surest route to sustainable non-inflationary growth is compliance with nominal convergence. The question here is not whether real convergence should be exclusive of nominal convergence or vice-versa. The real question is how to ensure the maximum possible coherence between real and nominal convergence. The explicit costs of one or the other must be addressed. Rapid economic growth can undoubtedly lead to inflationary pressures that will have negative

implications for future growth. Conversely, nominal convergence could stifle growth through deflationary monetary and fiscal policies that would push back real convergence. Each country will need to define the level of growth deemed appropriate within an inflation target deemed acceptable. Whatever the choices, it is important to bear in mind the employment and labour market dimensions of these policy issues and trade-offs.

A number of elements can be mentioned.

Employment as a central policy objective

The Employment Policy Convention, 1964, (No.122) calls for each Member to "declare and pursue, as a major goal, an active policy designed to promote full, productive and freely chosen employment". Accession countries should fully apply this principle and render explicit the employment implications of accession to the EU. The costs and benefits for employment of alternative routes to accession should be examined and discussed. In particular the potential conflict between a process of real and of nominal convergence and its employment implications needs further analysis. Closer trade integration between accession countries and the EU is bound to influence the level and composition of employment, in terms of its regional, sectoral and establishment-size distribution. Likewise, employment dimensions of mobilisation of domestic savings and investment for accelerated growth require closer investigation, as countries, depending on size, should not rely exclusively on accession and trade integration as sources of growth.

The case for coordinated wage bargaining

An important objective for accession countries is to achieve a rate of growth that will reduce unemployment without undesirable inflationary pressures. One important dimension of this difficult combination is coordinated wage bargaining. A number of European Union countries (foremost Denmark, Netherlands and Ireland) have shown during the 1990´s that low inflation, high growth and low unemployment were compatible. This is largely attributed to strong employers´ and workers´ organizations and their ability to coordinate wage agreements that are compatible with the overall macroeconomic constraints of each country. Independently of the degree of centralization of wage bargaining, usually a reflection of the level of organisation and strength of employers´ and workers´ organizations, the degree of coordination of wage bargaining is the important variable. The experience of these European countries is contrary to the widely held view regarding European labour market rigidity by which low inflation can only be achieved at the cost of a relatively high level of unemployment. Coordinated wage bargaining can sustain real wage increases in a context of low inflation with positive implications for the level of employment. Extensive consultations between the government and the social partners on economic and social policies are a characteristic of these few European countries.

This experience is of direct relevance to accession countries. First these countries will continue to experience rapid structural transformation, with some sectors modernizing more rapidly than others. This carries with it the prospects of wider wage differentials. Large inflows of foreign direct investment will tend to fuel such differentials. Pressures for wage equalization will therefore intensify. Second inflation expectations will tend to be tied to past inflation rather than to future inflation, given a reasonable degree of uncertainty about the pace of future inflation. Third the prospects of accession to the EU will stimulate demands for a rapid catch-up in living standards, wages and social benefits. These could quickly outpace what economic growth might permit. For all these reasons it seems important for accession countries and employers´ and workers´ organizations within these, to be in a position to effectively coordinate bargaining over wage increases.

Labour productivity, flexibility and labour standards

A key element in sustaining high levels of economic growth within a pattern of nominal convergence for entry into the EMU is a sustained increase in labour productivity. At the same time, accession countries need to raise their levels of employment, particularly of gainful employment. These may be seen as conflicting objectives. Labour productivity is dependent on many factors, from technology to work organisation, skills of the labour force, sectoral composition of output and the like. It is also highly dependent on trust and cooperation and security in employment. High levels of labour productivity and high levels of labour insecurity are not compatible. However, rapid structural transformation of the kind experienced by accession countries requires a certain degree of flexibility in order to facilitate the mobility of labour within enterprises and across occupations, sectors, regions and skills. Such flexibility can be achieved on the basis of a shared commitment to labour standards, particularly with regard to labour mobility. Whereas labour standards are at times perceived as part of the problem of rigid labour markets, which they indeed can be under certain conditions, they can also provide a basis for the flexibility required in rapidly changing economies (Sengenberger and Campbell, 1994). Rapid reform and structural transformation require a high degree of trust and cooperation within enterprises, among employers´ and workers´ organizations, and between these and the government at various levels. One example is industrial restructuring in several European Union countries during the 1980´s that has greatly benefited from the flexibility provided by a broad commitment to labour standards. Negotiated flexibility is a strategy applied in several countries with positive results. Among the more important labour standards in this perspective, one can mention those pertaining to social dialogue and collective bargaining, minimum wages to prevent downward wage competition, equality of opportunity, occupational safety and health as well as employment protection and social security, including unemployment benefits. Active labour market policies combining training opportunities with orientation and counselling have proven effective in various countries in securing employment flexibility and income security.

Labour supply

All accession countries, to the exception of Turkey possibly, are faced with rapid demographic ageing, and hence low labour force growth. The full use of existing labour force supply should therefore be a major concern. Countries need to consider raising the labour force participation rate, or maintaining high levels of participation. In eight of twelve countries labour force participation rates are lower than the average for the EU (Table 13). This is due not to lower female labour force participation (eight countries show higher rates for women than the EU average), but to lower male participation rates in all 12 countries but one, the Czech Republic. An important objective of labour market policy is to facilitate the return to employment of all those who wish to work.

Table 13: Labour force participation rates (15-64 years, 2000)

	Total	Male	Female	
Bulgaria	58.89	63.27	54.62	
Czech Republic	71.40	79.21	63.57	

Estonia	70.79	76.67	65.30	
Hungary	60.25	68.05	52.72	
Latvia	67.55	72.47	62.99	
Lithuania	70.94	75.04	67.09	
Malta	38.40	55.70	21.50	1999
Poland	65.76	71.72	59.94	
Romania	68.58	75.40	61.85	
Slovakia	69.66	75.96	63.46	
Slovenia	67.85	72.25	63.34	1999
Turkey	54.82	77.90	32.76	1999
EU	69.50	78.90	59.80	
Source: ILO Yearbook of Labour Statistics and OECD.				

A similar picture emerges when looking at employment rates (or employment to working age population ratios) (Table 14). Accession countries differ from the EU-15 average with regard to lower youth employment rates, and lower rates of women aged 55-64 years. Conversely, employment rates of

women aged 25-54 years are higher than the EU average, but generally lower for men.

Table 14: Employment to working age population ratios by age and sex (2000)

	Bulgaria	Czech Rep.	Estonia	Hungary	Lithuania	Latvia	Poland	Romania	Slovakia	Slovenia	Turkey	EU-15
All												
15-24	19.3	36.4	27.4	33.1	26.7	30.4	24.1	34.0	28.3	31.2	36.3	40.8
25-54	67.3	81.5	76.8	72.8	76.0	74.2	71.0	78.6	74.2	82.6	56.2	76.6
55-64	18.9	36.1	43.0	21.9	42.2	35.4	29.0	52.0	21.5	22.3	35.3	38.5
15-64	49.2	64.9	60.6	55.9	60.1	58.2	55.1	64.2	56.3	62.7	48.2	63.6
Male												
15-24	21.3	39.3	31.4	37.0	30.2	35.2	26.4	36.9	28.7	34.7	49.1	44.8
25-54	69.4	89.2	79.5	79.0	75.1	75.4	77.5	84.6	79.1	85.5	84.9	87.5
55-64	31.1	51.6	50.2	33.0	52.2	48.3	37.4	57.4	35.2	31.0	51.4	48.9
15-64	53.4	73.1	64.3	62.7	61.8	62.3	61.2	69.5	61.6	66.7	71.2	73.2

Female												
15-24	17.3	33.6	23.2	29.2	23.2	25.6	21.9	31.1	27.9	27.4	23.9	36.7
25-54	65.2	73.7	74.2	66.7	76.8	73.0	64.5	72.7	69.3	79.6	26.6	65.7
55-64	8.5	22.1	37.5	13.0	34.5	25.9	21.8	47.3	10.2	14.3	19.9	28.4
15-64	45.3	56.8	57.1	49.4	58.5	54.3	49.3	59.0	51.1	58.5	25.1	53.9
Source: EUROSTAT and OECD.												

These two sets of data suggest that there is still scope in accession countries to raise the employment rates of distinct segments of the labour force in order to sustain an adequate level of supply. Raising employment rates of specific categories of the labour force is not simply a question of higher levels of aggregate demand. This requires specific policy tools to lift the obstacles particular segments of the labour force may experience in the labour market. This is particularly the case for women workers whose participation rates were and remain relatively high. This is highly dependent on a wide access of families to support mechanisms for childcare.

The case for active labour market policies

In a period of rapid structural transformation, labour market policies are required to maintain an adequate equilibrium between labour demand and supply, in particular by facilitating entry and re-entry into employment. As evidenced above, any given level of labour demand can be highly differentiated in terms of its gender, age, and regional and skills composition. Labour market policies, at the crossroad between labour legislation, labour market institutions and the labour market, should seek to redress the imbalances that may occur. Strict reliance on the market is likely to be inefficient in view of the many imperfections that arise in the allocation of labour (inadequate information, transaction costs, mobility constraints and segmentation). Labour market policies need to strict a balance in each country between employment and social protection, stability and mobility, income security and employment flexibility. In general one tends to oppose low levels of protection and high levels of labour market flexibility on the one hand with higher levels of protection and lesser flexibility in the labour market on the other. A mixed approach worthy of some interest is one adopted in some Nordic countries combining low employment protection, high income security in the form of unemployment benefits and active training and counselling in job search. Recent research seems to indicate that income insecurity, rather than strict employment protection, is a factor behind lower labour mobility

(Cazes and Nesperova, 2001). Greater employment mobility could be facilitated with more investment in training opportunities for youth and in retraining for experienced workers. Early retirement options, as well as the modalities of unemployment benefit systems and social welfare systems (replacement rates, duration and entitlement criteria) may need to be reviewed. The ability to adapt policies to changing labour market conditions is usually premised on a high degree of consultations with employers´ and workers´ organizations. In periods of rapid structural transformation, such consultations may provide the key to an adequate combination of flexibility and protection.

As accession countries comply with the nominal convergence criteria defined by the European Union in order to qualify eventually for entry into the EMU, their macroeconomic policy options will become narrower. Fiscal policy and possibly incomes policy will be the only instruments over which some degree of autonomy will be retained. A labour market policy of the kind mentioned above, based on wide acceptance and compliance with labour standards, will be an important means of regaining some space for macroeconomic policy. Fiscal policy itself will be quite dependent on the level of employment and of wages, and on the degree of social cohesion that labour market policy and fiscal policy can jointly foster. In this sense, labour market policy based on labour standards appears as a critical variable in order to ensure the desired coherence between real and nominal convergence.

Conclusions

This note has strived to point to some reasons why particular attention to employment and to decent work within economic and social policies was required in the case of countries candidate to membership in the European Union. Four dimensions have been mentioned. The full participation of employers´ and workers´ organizations, through extensive and coordinated social dialogue, in the combined consideration of wage adjustments and employment, can ease the real macroeconomic constraints accession countries are and will continue to face. Higher levels of employment are required in order to maintain fiscal constraints within an acceptable balance, and to finance needed social expenditures. A policy of full employment and decent work is an important element foundation of equity and social cohesion. Sustained increases in labour productivity are an important dimension of competitiveness. Such increases could not be sustained in the absence of adequate levels of employment security, social protection and trust and cooperation. Finally, labour standards were found to be particularly useful tools in a period of rapid structural change. These should inform labour market policies that accompany such transformations. These four dimensions form the basis of a policy for decent work and competitiveness.

The precise combination and integration of economic and social policies will depend on the characteristics prevailing in each country. However, country experience can usefully be informed by similar experiences in other countries. The ILO could pursue its role as a forum for discussion and exchange of information.

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