SUMMARY

UNDER EMBARGO UNTIL 22:01 GMT TUESDAY 10 JULY 2012

Eurozone job crisis:

Trends and policy responses

Executive Summary

INTERNATIONAL LABOUR ORGANIZATION

INTERNATIONAL INSTITUTE FOR LABOUR STUDIES

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Employment remains depressed in the majority of Eurozone countries…

Labour markets in the Eurozone have not yet recovered from the global crisis that hit the world economy in late 2008. Total employment remains 3.5 million lower than before the crisis. Most alarming, following a modest recovery in 2010 and 2011, employment has fallen since the start of 2012 in half of the Eurozone countries for which recent data are available. By April 2012, the Eurozone unemployment rate reached 11 per cent, representing 17.4 million jobseekers.

Some countries have been hit more severely than others. Job losses were especially acute in southern Europe. Austria, Belgium, Germany, Luxembourg and Malta are the only countries where employment is now higher than in 2008. However, even in these countries, there are signs that the labour market situation may no longer be improving. The quality of jobs has deteriorated as well, even in many of the relatively successful economies.

… and a further 4.5 million jobs may be lost…

The report shows that by embracing a Eurozone growth strategy with jobs at its core, a recovery is still possible within a single-currency setting. Repairing the financial system, promoting productive investment, reinforcing effective employment programmes, maintaining social protection, fostering social dialogue and undertaking job-friendly fiscal plans would bring the Eurozone out of the austerity trap and pave the way for a sustainable recovery with social cohesion.

If the current policy course does not change quickly, however, it is possible that a further 4.5 million jobs will be lost over the next four years. This would risk further feeding social unrest and eroding citizen's confidence in national governments, the financial system and European institutions.

Mounting evidence points to the fact that a prolonged labour market recession may be in the making. Long-term unemployment is on the rise and many workers are becoming excluded from the labour market. At the beginning of 2012, around 31.5 per cent of the working-age population in the Eurozone were either unemployed or inactive an increase of 1.5 percentage points from 2007. And 44 per cent of unemployed people had been without work for more than one year.

Young people are increasingly at risk of a scarring first experience in the world of work, which could affect them for the rest of their life. In April 2012, the youth unemployment rate in the

Eurozone was over 22 per cent. It exceeded 30 per cent in Italy, Portugal and Slovakia and was over 50 per cent in Greece and Spain. Youth unemployment rates also remained relatively high in successfully performing countries, such as Belgium and Malta.

Without a prompt policy turn – to address the crisis and to regain the trust and support of workers and enterprises – it will be difficult to implement the reforms necessary to put the Eurozone back onto a path of stability and growth.

… questioning the primacy of fiscal goals as the backbone of the policy strategy.

There is growing awareness that an approach based narrowly on fiscal austerity will affect employment, while also failing to cut fiscal deficits significantly. Economies with a more growth-oriented policy strategy show better performance in terms of jobs, investment and financial stability. More fundamentally, the conditions under which fiscal austerity might have worked have simply not been met.

Fiscal austerity has encompassed sharp cuts in public investment and in pro-employment programmes, thereby affecting domestic demand directly. The pace and scale at which these measures were introduced has outweighed any positive demand components, inducing an overall recessionary effect. As more and more countries shift to fiscal austerity, the scope for exports to outweigh austerity-driven declines in domestic demand has become very limited.

Similarly, 13 out of 17 Eurozone countries have carried out labour market flexibility reforms, often in the direction of easing dismissals. However, in a depressed macroeconomic context, these reforms are likely to lead to increased numbers of layoffs without any boost to job creation at least until economic recovery gathers momentum.

The austerity approach has side-lined the much-needed reform of the financial system, the epicentre of the crisis. Indeed, action on this front has proceeded slowly. The result is that, in countries hit by recession, banks have not resumed their normal role of providing loans to the real economy. In 2011, private investment as a percentage of GDP fell in all Eurozone countries except one, despite low interest rates and the ample liquid assets held by large firms. The trend is especially problematic for small firms, which account for over two-thirds of employment in the Eurozone.

Finally, significant cross-country differences in competitiveness remain within the Eurozone. While unit labour costs have converged somewhat since the start of the crisis, little attention has been paid to the role that a coordinated growth and jobs strategy could play in attenuating intra-Eurozone competitiveness imbalances.

Addressing the jobs crisis in the Eurozone requires, first, repairing the financing system urgently …

No recovery will be possible unless the financial system is repaired. In past expansionary episodes, an increase in investment equivalent to 1 per cent of GDP has been associated with an additional 1.4 million net new jobs in the Eurozone as a whole over around two years. This suggests that if credit channels were restored and the ratio of investment to GDP was brought back to its pre-crisis level (meaning a rise in the investment to GDP ratio by less than two percentage points to 21.5 per cent), around two-thirds of the jobs lost since the start of the crisis would be recovered.

Repairing the financial system means addressing quickly the solvency problems of many banks. There is a strong case for moving towards banking union, provided that the shareholders of ailing banks – which, along with the managers they elected, have prime responsibility for the toxic practices that prevailed and generated large dividends in good times – contribute to cover the losses. The involvement of large bondholders may be necessary as well. This is all the more important because bank restructuring will inevitably lead to increased public liabilities. The Eurozone Summit Statement of June 29th provides a step in the right direction, which however requires concrete follow up measures.

A new regulation to prevent any recurrence of past inappropriate practices is also called for. This means reinforcing prudential control at the Eurozone level, addressing excessive risk taking and remuneration practices not linked to the performance of the sector, clarifying responsibilities for the current state of some banks and taking economic and legal action as needed, and ensuring that banks focus on their original intermediary role instead of developing own-account activities. Here too, recent proposals by the European Commission go in this direction, but require concrete follow up action. It will also be necessary for the ECB to take a stronger role in this area.

… second, promoting growth and jobs, taking into account initial country conditions, including through well-designed investment and income policies …

Promoting investment would go a long way towards improving job prospects in countries hit by the crisis, restoring competitiveness and reducing internal Eurozone imbalances. This requires improving credit conditions for small enterprises and strengthening or creating systems of guarantees for loans to these firms, as well as public incentives for investment or direct public investment with a potential to crowd in private initiatives and create jobs. Launching a reindustrialization strategy in these countries would help to improve coherence between the different policy instruments.

Surplus countries have room to rebalance growth in order to cushion the effects of weaker demand from crisis-hit countries and to support the overall adjustment in the Eurozone. A rise in wage rates in line with productivity growth, as has started to happen, would contribute significantly to the rebalancing process. Addressing the high incidence of non-standard employment would also help.

Deficit countries, on the other hand, have restored cost-competitiveness to some extent. On average, half of the relative increase in unit labour costs since the introduction of the Euro has been reversed since 2008. This has come about through real wage cuts and labour productivity improvements. Prices, on the other hand, have adjusted only slightly, thereby weakening the effect of reduced unit labour costs on competitiveness in deficit countries and adding to the hardship of those whose incomes have fallen.

Going further, addressing competitiveness problems without provoking a deep and long recession will require measures that boost productivity and achieve price moderation in deficit countries, and a recovery in wages in surplus countries after a number of years in which wage rises lagged behind productivity. Furthermore the overall internal Eurozone rebalancing should not weaken the region's competitive position with other counties.

In all cases, there is a significant role for social dialogue on incomes policy. Far from preventing adjustment, coordinated collective bargaining would facilitate the transition to a more competitive Eurozone while boosting confidence that responses are fair. In this respect, recent moves in some countries to weaken or suspend collective bargaining are counterproductive.

… effective employment programmes, including youth guarantees…

Employment policies, notably well-designed active labour market programmes, could play an instrumental role in promoting job recovery. Making sure that young people are not trapped in precarious jobs is important as well. Some countries, such as Austria, have found ways to ensure that temporary jobs are stepping stones to more stable arrangements – instead of a dead-end. This requires careful design of regulations.

In a number of Eurozone countries, such as Austria, Belgium and the Netherlands, new training programmes have facilitated school-to-work transition and ensured that young women and men remain connected to the labour market. Here, the successful delivery of these programmes will hinge on the availability of well-resourced public employment services.

The launch of a special programme for youth unemployment, along the line of the "youth guarantees" in Nordic countries, is particularly urgent. Under such guarantees, the government commits itself to offer young women and men in a defined target group – unemployed, not in education or with a short employment experience – a place in an education, training or work programme or special job-search support. No young person would thus be left behind, for a budget cost estimated at less than 0.5 % of Eurozone government spending. In Sweden, 46 per cent of young jobseekers had successful job outcomes as a result of the guarantee.

… realistic fiscal plans to support jobs while meeting deficit goals in the medium term…

It is essential to bring fiscal deficits down to sustainable levels in the medium-term. Yet, the pace and nature of deficit reduction measures can complicate the achievement of budget goals. This is why a job-friendly fiscal consolidation approach would not only be socially responsible but would also contribute to boost economic growth and to meet budget goals.

In particular, some of the above-mentioned policies require fiscal support. This may be partly compensated by cuts in wasteful spending or by tax measures. In this regard, the broadening of the tax base on property or certain types of financial transactions would be especially timely, as these taxes are less distortive than taxes weighing on work and real investment. Refocusing European Structural Funds on jobs and mobilizing the European Investment Bank to support investment projects would also represent strategic moves. More importantly, the evidence presented in the report shows that such a policy would be rewarded by better job prospects and improved fiscal balances in the medium term.

… and third, greater policy coordination in the Eurozone to support the common currency …

The current crisis has made it clear that in a globalized world economic shocks ignore national borders and that economic imbalances in one country are easily spread to the whole Eurozone and beyond. It is essential that the risk arising from onerous sovereign debts and the undercapitalization of private banks be addressed in a coordinated manner.

Citizens are losing confidence in governments' capacity to manage economies. Citizens and governments question the rationality and probity of financial markets which in turn are losing confidence in governments' ability to finance fiscal deficits. "Confidence" is thus a complex of relationships which requires a comprehensive and coordinated policy effort by Eurozone members.

The reinforcement of the relevant Eurozone and EU institutions is therefore of the essence. Greater coordination may have started to happen, as exemplified by the Eurozone Summit Statement of end June. Earlier on, in April 2012 the European Commission adopted an Employment Package with the aim of supporting growth and jobs, strengthening EU institutions and the position of social partners and creating a genuine EU labour market. The European Commission's proposed Action for Stability, Growth and Jobs, released in May 2012, further develops this new approach. In particular, the Action recommends that Member States "ensure that their wage setting mechanisms appropriately reflect productivity developments and stimulate job creation" and calls for greater implementation of active labour market policies.

Such an approach, by arresting the onset of a vicious downward spiral and starting a virtuous spiral of increasing employment, investment and consumption, can facilitate recovery and restore competitiveness. It can also contribute to the application of the EU Treaty's horizontal social clause, and to the promotion of social dialogue and the rights and principles guaranteed by the EU Charter on Fundamental Rights, the conventions of the Council of Europe and ILO international labour standards, all widely ratified in the EU.

The extent to which the Eurozone problems can be addressed depends also on the ability of other major global players to support sustainable recovery, especially those where exports to developed countries had been the main driver of growth. Exacerbated financial stress in the Eurozone would have dramatic consequences for the rest of the world economy.

In general, the depth of the adjustments required to end the crisis is such that any policy strategy also needs to have the support of social partners in order to be credible. In this respect, social dialogue is not only a means for ensuring an equitable distribution of the efforts necessary for the recovery and thus citizens' confidence in governments, but also a key "collateral" for investors.

A jobs pact is vital for the stability of the Eurozone as a single-currency area.

The crisis has raised enormous challenges for the Eurozone. There are risks concerning its stability as a single-currency area. The report shows that further financial stress in the Eurozone would lead to significantly higher unemployment in the short-run, both in deficit countries and in their surplus counterparts. All countries would lose, so every country has an interest in changing policy course. And contagion to the other EU labour markets and the entire world economy would be unavoidable.

The report shows that by embracing a Eurozone growth strategy with jobs at its core --along the lines described above-- a recovery is still possible within a single-currency setting. The ILO Global Jobs Pact and Call for action on youth, as recently launched by the International Labour Conference, offer a portfolio of policies on which Eurozone countries could continue to draw. Other global players, especially those that have relied on export-led growth, also have a role to play to support balanced recovery.

The window of opportunity is closing. However, the experience of Sweden, which overcame its financial crisis in the early 1990s through an inclusive strategy, shows that a positive dynamic can be put in motion. Such a growth and employment strategy would be instrumental in boosting confidence in the sustainability of the Eurozone as a single-currency area.