More and better jobs? – Labour market developments in the euro area since 1999

Companion report to the ELNEP economic forecast and policy recommendations, May 2008

Introduction

Irrespective of the increased attention recently focussed on financial markets, and the claims of some that work has lost its central importance in people's lives, of all the markets in a market economy it is the state of the labour market that is decisive for the economic and also social well-being of the vast majority of Europe's citizens. All but a small minority of households depend for their living standards on one or more members holding down a decent job. Alongside wage and salary income, the quality of work and the ability to reconcile paid employment with other responsibilities and life-interests are key determinants of well-being.

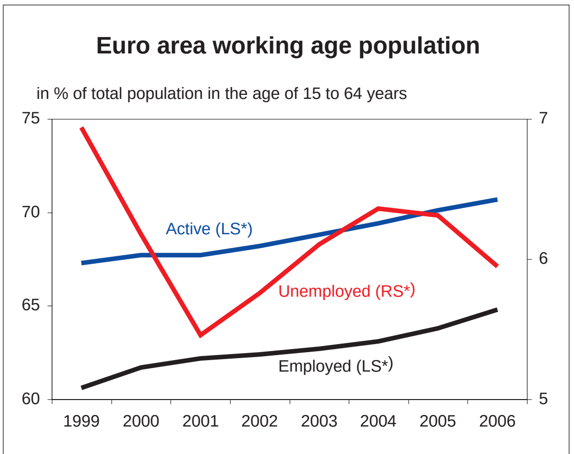
At the same time the labour market determines other important economic outcomes. Rising labour productivity is a key driver of economic growth; wage increases and employment growth drive consumption and also exert an important influence on the state of government budgets; the wage-productivity nexus is vital both for competitiveness and helping to ensure price stability.

For these reasons the ELNEP report, unlike other economic forecasts, devotes a separate chapter to labour market developments. At the end of this year we will be able to look back on ten years of European Monetary Union. With this in mind we provide an overview of key labour market developments since the start of EMU in 1999.

Employment and unemployment

Raising the proportion of the working-age population in employment is a key goal of the European Union's Lisbon Strategy, which set employment-rate targets – for the whole European Union – of 70%, 60% and 50% for the total employment rate, women and older workers (55-64) respectively. They were to be reached by 2010. In the euro area the starting levels in 1999 were 61%, 51% and 34% respectively. Clearly, achieving the targets means that the number of people in

Figure 1



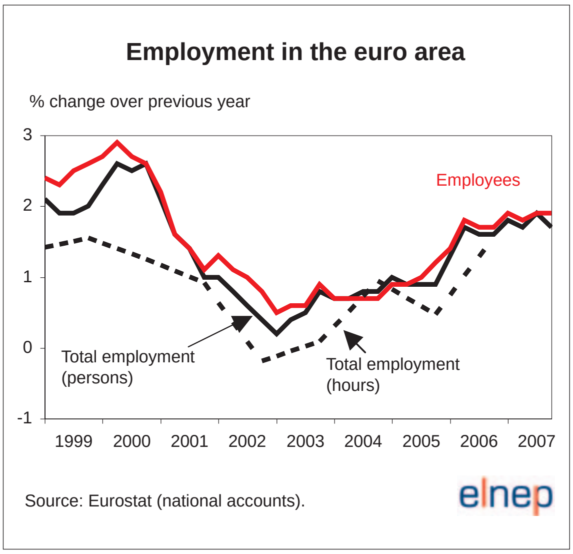
*LS=Left-hand scale, RS=Right-hand scale.
Source: Eurostat (LFS), ELNEP calculations.

work has to grow faster than the relevant population (the working-age population for the first two and the population aged 55-64 for older workers).

Since 1999 the working-age population has increased only very slowly (an average of 0.3% p.a.). By contrast total employment has risen at an average rate of 1.3% a year. Some 13 million jobs were added over the period, a 10% employment increase in terms of persons. Against the background of the sluggish growth in the working age population, this raised the employment rate from 60.6% to 64.8%. Figures 1 and 2 show the trend over time, and indicate the proximate source of the problems in achieving the overall Lisbon target: in the periods of buoyant economic growth at the start and the end of the period, employment growth was strong, at or (in 1999 and 2000) even above 2% a year. However, the four years from 2002 to 2005 were characterised by sluggish employment growth – below 1% p.a. Correspondingly, in those years there was virtually no progress in raising the employment rate. The sensitivity of employment to the business cycle is starkly brought out by the fact that the employment-rate increase in 2006 alone was substantially greater than that achieved in the years 2001-2005: it seems hard to argue that this was due to a sudden reduction in 'labour market rigidities'. Rather this clearly reflected the long-overdue economic upturn.

It is important to note in Figure 2 the (small) differences in the growth rates of total employment and those of employees, and the (considerably larger) gaps between employment growth measured in persons and in working hours. The former is due to the secular decline in self-employment (not least in agriculture) in a number of euro area countries, and also appears to be cyclically sensitive, the gap widening at the top of 'booms' and the bottom of 'busts'.

Figure 2

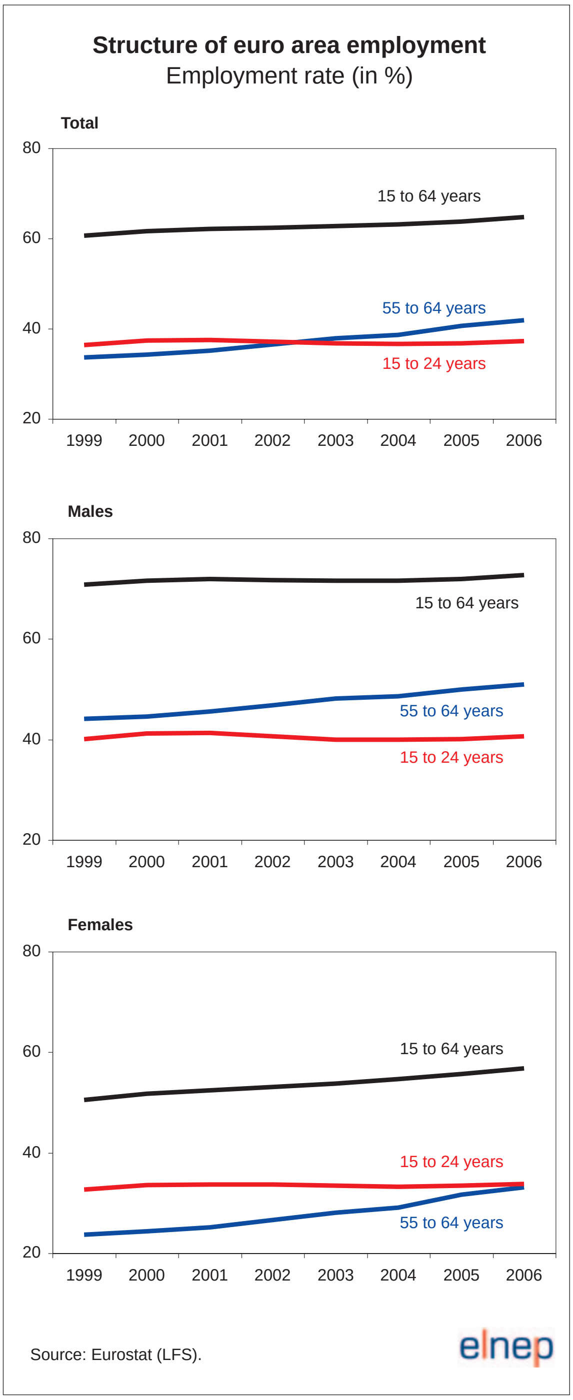


Hourly data is, in principle, more telling of the overall state of the labour market than counting 'heads'. Unfortunately, however, they are less reliable than for employment in persons, and, a drawback especially for forecasting, they are not available as timely. The graph suggests a decline in the average hours worked per person in the euro area. This, in turn, is due to two main factors: increasing part-time employment (of which more later) and a decline in average full-time hours. Continued employment growth in Europe in the face of sluggish economic growth has been frequently remarked upon: there has even been talk of 'growthless jobs'. While productivity growth has been weaker, a phenomenon addressed in detail below, as Figure 2 makes clear, this apparent paradox is partly due to a working-time effect: total working hours growth was zero or negative throughout 2003 and only about half the growth rate measured in persons in 2004.

Progress in raising employment rates has been much faster among women than men – of course starting from a lower base. The share of the female labour force in work (part or full time) has risen from around 51% to 57%, making attainment of the 60% target a realistic possibility, provided the renewed economic slowdown can be arrested. This development represents both demand-side factors (such as the steady expansion of service employment at the cost of male-dominated manufacturing) and supply-side changes (increased education levels and changing family structures and social attitudes, and in some cases measures providing adequate child and elderly care).

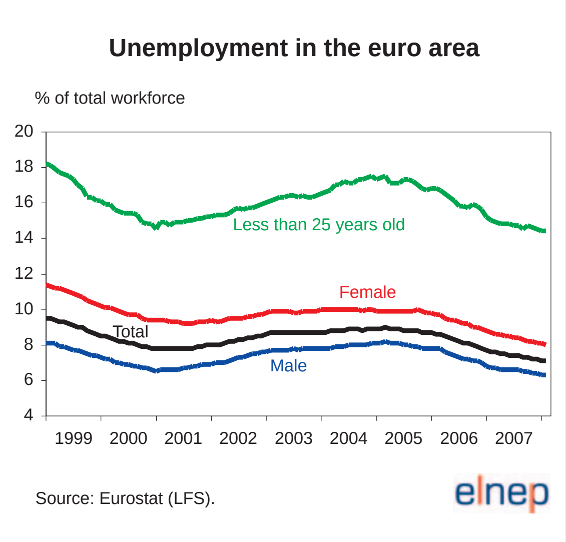
Similarly, progress has been above average in bringing elderly workers into employment, albeit from low levels (for instance compared with the US). The employment rate has risen by some 8 p.p., reflecting public policies to increase the incentives to stay in the labour market and in some cases downward pressure on pensions and the tightening of entitlement conditions to disability and other benefits. By contrast the employment rate of young workers has remained virtually constant over the period. This is the outcome of two contradictory – but both welcome – trends: young people remaining longer in education, on the one hand, and improved labour market chances (as reflected in declining youth unemployment) on the other.

Figure 3



Unemployment has long been considered ‘economic policy problem number one’ in Europe, and especially in the euro area. The unfavourable comparison with, especially, the US and UK has been widely seen as ‘proof’ that the ‘European Social Model’, whatever its advantages in terms of equality and other social outcomes, condemns economies to high unemployment. Although there is no official unemployment target in the Lisbon Strategy, in 1997 the EU launched the European Employment Strategy (EES) with the aim of improving labour market performance and reducing unemployment. How has the euro area performed in terms of unemployment since 1999?

Figure 4



In absolute terms unemployment (as defined on a standardised basis by Eurostat) has been reduced by more than 1.6 million persons (or 13%) since 1999; still, in 2007 11.2 million persons were unemployed in the 13 euro area countries. Measured as a proportion of the working age population (as in Fig. 1), unemployment fell from 6.9 to 5.9%; however this was only fractionally lower than in 2001: the subsequent economic stagnation led to small but steady rises in unemployment as a share of the working age population.

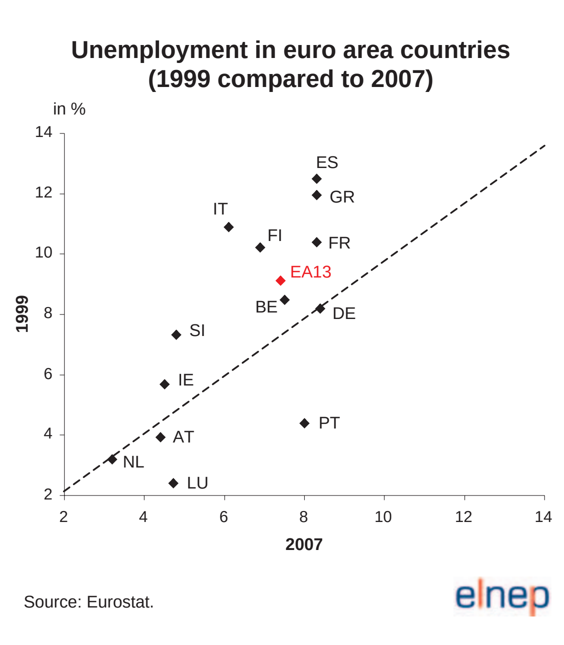
Turning to the more familiar unemployment rate, i.e. the unemployed as a proportion of the labour force (the sum of employment and unemployment), it has come down by more than 2 percentage points to 7.1% in early 2008 (Fig. 4). This is the lowest figure for decades, although it remains higher than in the US and non-euro area EU15 countries. The male and female rates follow the overall trend closely. While female unemployment is consistently higher than for men, the gender unemployment gap has narrowed considerably: the male and female figures are now less than one percentage point from the total rate, and unemployment among women has declined by 3.5 percentage points, compared to 1.8 points for men.

Youth unemployment also closely follows movements in the overall trend, but at a much higher level, roughly double the overall rate, representing a key blight on euro area labour markets. It is true that the youth unemployment figures are much lower when expressed as a proportion of the overall population aged 15-24, i.e. including the high and rising number of youngsters in education. However, this indicator is also hard to interpret, as young people may remain in education or training precisely because of a lack of opportunities on the labour market.

Figure 5 clearly shows the broad-based – in geographical terms – improvement in the unemployment situation in the euro area: only Portugal suffered a substantial rise in the unemployment rate over the period[1]. There was a slight up-tick in Austria and no improvement in either Germany or the Netherlands (although the latter was arguably at a situation approximating to 'full employment' already in 1999). The biggest reductions were achieved by those countries in which unemployment had initially been highest (Spain and Greece), with big improvements also in Italy and Finland. This

[1] The rise in Luxembourg was from an extremely low level.

Figure 5



pattern implies a marked convergence of unemployment rates across the currency zone; the rate gap closed from around 10 p.p. in 1999 to just over 5 p.p. by 2007. Some may be tempted to see this as a sign of 'policy learning' from good performers, as envisaged in the EES; this is open to debate. To an important extent it reflects an EMU effect: previously high-unemployment countries such as Spain and Greece benefited from a substantial fall in interest rates and consequent dynamic economic growth on joining the currency union.

The decline in unemployment has given rise to claims that the euro area is operating close to capacity or to the NAIRU (non accelerating inflation rate of unemployment), which would imply wage and thus inflationary pressure and a need for tighter demand-side policies. This issue is addressed with regard to the current situation in the wage policy section of the main report. However it is interesting to look at the issue of labour market slack and wage trends over the life-time of the EMU.

Labour market slack, wage growth and labour costs

In fact it is not at all easy to determine the degree of labour market tightness, particularly in a heterogeneous currency area, where responsibility for labour market management, labour market policy and, not least, wage setting, remains almost solely at national level.

Figure 6

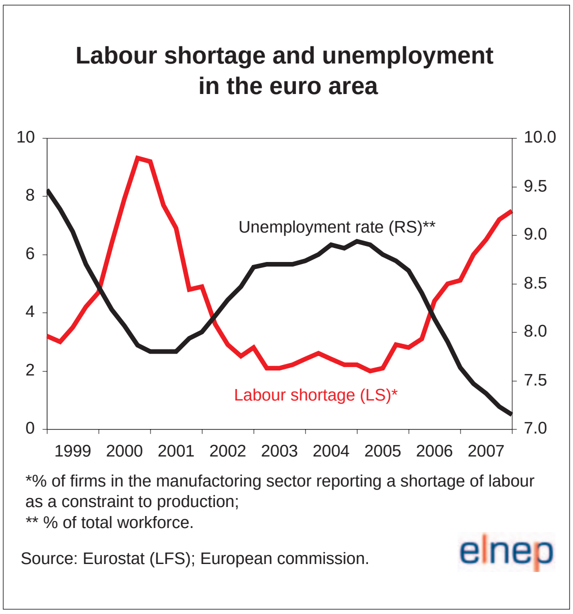


Figure 6 indicates, based on survey data, the proportion of firms reporting a shortage of skilled labour as a constraint on production. This is harmonised quarterly data. It has the drawback of applying only in the manufacturing sector, representing less than 30% of employment in the euro area. Also employers may have an incentive to 'over-report' such shortages in pursuit of goals such as training subsidies or changes in restrictive regulations (although even then changes over time ought to be informative). The graph shows the expected inverse relationship between unemployment and the perceived shortage of labour. (The same data, plotted on different axes, gives a version of the so-called 'Beveridge Curve'.) Noteworthy is the sharp rise, and equally abrupt subsequent fall, in the proportion of firms facing labour constraints in the period 2000-2002, which rose from 3 to 9.3% in just six quarters.

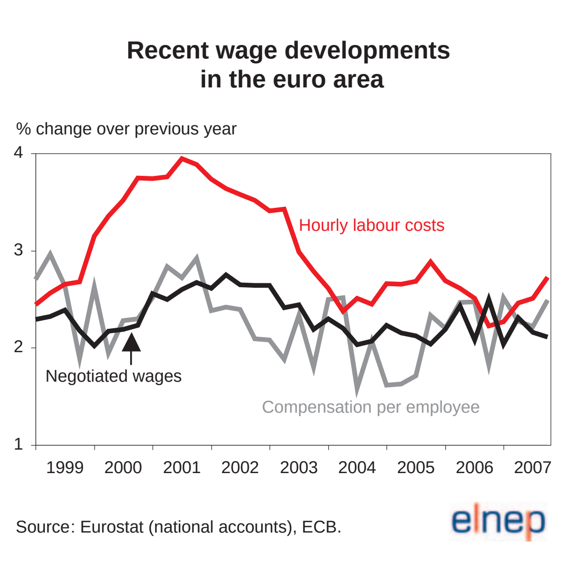
Importantly for interpreting the current situation, unemployment is now more than half a point lower than the previous low-point, but the number of firms experiencing labour shortages has only risen to 7.5%. Unless there has been a shift in employer perceptions irrespective of actual labour supply factors, this indicates an improved supply-side responsiveness of the euro area labour market: the Beveridge Curve has shifted towards the origin, and it has flattened. There are a number of potential explanations for this. One is labour market reforms that increase pressure on the unemployed to be available for the labour market and/or policies that raise the skills, mobility and motivation of the unemployed. Another is employers' increased access to foreign labour. It is noticeable that the improved figures come after the enlargement of the EU in 2004, which facilitated the access of workers from eastern Europe to euro area labour markets; on top of this, countries such as Spain have experienced substantial inward migration from outside the EU.

Data on job vacancies are known to be problematic even at national level, as they can be influenced by changes in the extent to which employers report their job openings to the relevant authorities. Eurostat has a quarterly harmonised series for the EU15 expressing vacancies as a percentage of labour demand (the sum of vacancies and occupied posts). It shows the vacancy rate flat (at 1.6-1.8%) in 2003-2005, from which level it rose slightly to oscillate around 2.3% in 2007. This points to a tightening, but it is hard to evaluate its extent.

In view of such problems, it is arguably best to look directly at wage data: if labour markets are tightening, this should show up in a stronger bargaining position for labour in negotiations with employers, and thus in a faster pace of wage growth. Given that wages reflect, besides relative bargaining strength, in particular also inflation and productivity, we need to consider, alongside nominal wage growth, indicators that take these factors into account.

As regards nominal wages there are three main indicators available for the euro area on a quarterly basis: the time series are reproduced in Figure 7. 'Negotiated wages' is compiled by the ECB based on information derived from national central banks. It covers wage increases in collective agreements and thus excludes pay changes agreed at the individual level, 'voluntary' payments by employers and changes in taxes and social insurance contributions that can affect workers' take-home pay and firms' labour costs. It also misses compositional changes (e.g. rising part-time work). (Our own analysis of current collective agreements can be found in the main report in the section on wage policy). Compensation per employee is a comprehensive national accounting concept that

Figure 7



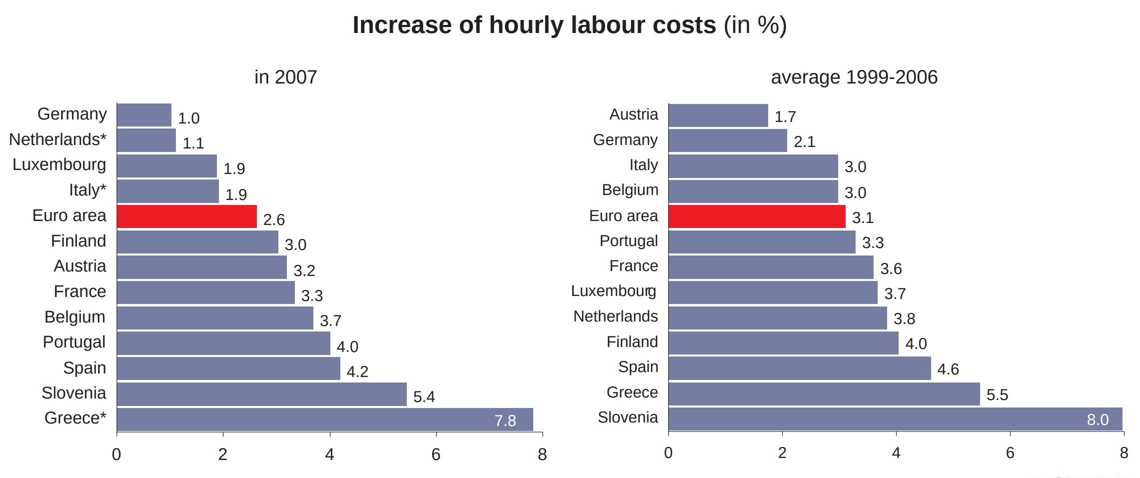
includes all payments by employers to workers; for forecasting it has the disadvantage that it is not available in a timely way.

What is most striking about these two series is the way they fluctuate within a narrow band between 1.6% and 2.6% a year: in only four quarters and never since 2001 has either series exceeded an annualised rate of 2.6%. The annual average increase for both series is 2.3%. This is only slightly above the ECB's implicit inflation target of 1.9% and marginally above the average annual increase in the cost of living (HICP) at 2.1%: real wage growth in the euro area as a whole has been extremely sluggish. Moreover, the series are seemingly rather insensitive to the state of the labour market and economy. There was a somewhat delayed and muted acceleration of wages in 2001 after the last pick-up in economic activity; more recently though, the pace of wage increases has been mixed: nominal compensation fluctuated, ticking up slightly in the final quarter, while collectively agreed wages were actually on a downward trajectory during 2007; hourly labour costs, discussed next, rose during 2007 by around 1/3 of a percentage point.

In principle the hourly labour cost measure (calculated by the ECB) is a better indication of pay trends, but has the disadvantage that hours data are based on surveys and are considered unreliable. From the perspective of labour it also has the drawback that it varies with changes in tax and contribution rates. This measure has been growing at a consistently somewhat higher rate than the other two series (average of the annualised quarterly values: 3.0%). This implies real increases in hourly gross earnings of just under 1% a year over the period as a whole, although whether this directly benefits workers in the form of higher take-home pay depends on changes in taxation and social welfare systems. While such changes may partly explain the gap with the other two series, the main reason for the difference is the increase in part-time work (see below).

Be that as it may, an interesting feature is a somewhat greater cyclicality of the hourly-cost data: at the end of the 2000/01 boom hourly labour costs briefly touched an annualised growth rate of 3.9%. Similarly to the discussion of labour market constraints above, it is noteworthy that, despite the marked fall in unemployment, the rate of growth of hourly labour costs is markedly lower than in the previous upturn. This analysis confirms that, for whatever reason, the euro area is clearly able to reduce unemployment to lower levels than before without tighter labour markets igniting wage pressure.

Figure 8



Source: Eurostat (national accounts; industry and private services), *data for 2006 (2007 not yet available).

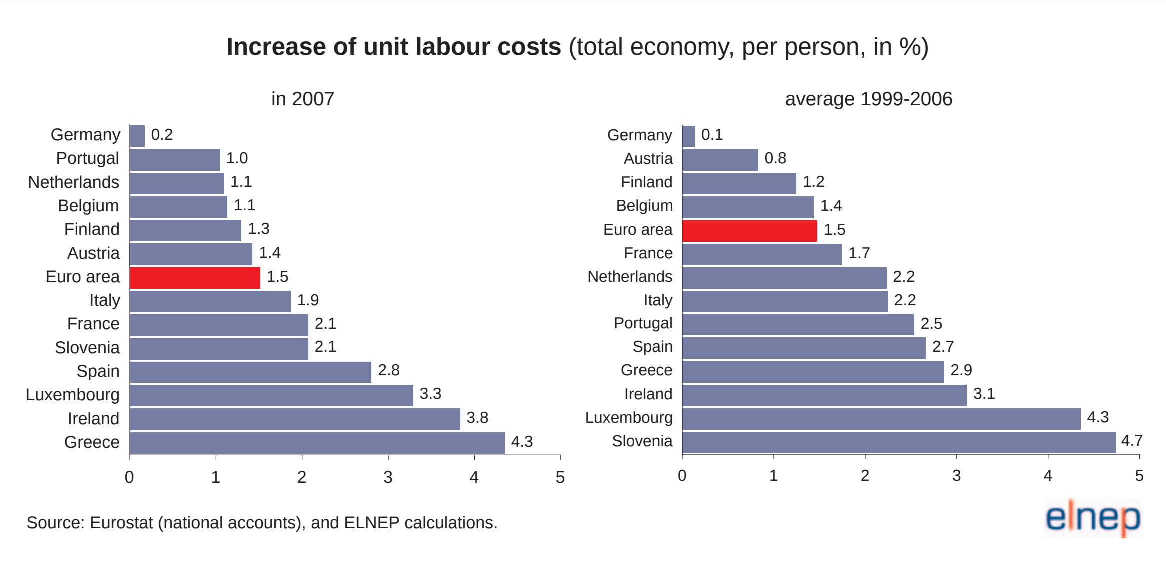
In conclusion nominal wage growth in the euro area has been subdued and seemingly less responsive to the state of the labour market. Along with the Beveridge curve, the Phillips Curve – relating unemployment to wage inflation – also appears to have flattened markedly.

Figure 8 shows the country breakdown for hourly labour costs over the period and for 2007. Many euro area countries have kept relatively close to the average figure, at least over the period as a whole. Strikingly, Austria and Germany, the largest EMU member, have undershot the average by more than one percentage point over the whole period (although in 2007 Austria accelerated markedly to above the annual rate of growth). At the other end of the distribution this was offset by three countries, Spain, Greece and Slovenia with nominal hourly wage growth in excess of 4% up to almost 8% a year. Luxembourg and the Netherlands are a mirror of Austria, decelerating after an earlier period of substantially above-average wage growth to below average in 2007.

Such increases need to be seen in the context of the growth of productivity. It is changes in unit labour costs (ULCs) – wage minus productivity growth – that is decisive for firms' costs and thus for inflationary pressure, and consequently for countries' external competitiveness. Figures 9 and 10 present two measures of ULCs, in terms of persons and of hours. This scarcely affects the country rankings, but it does change the absolute numbers; we focus here on the more important hourly data, with some reference to the person-based data for 2007, not yet available on an hourly basis.

Immediately striking is the negative ULC development in Germany over the period, which actually intensified in 2006 and, on the basis of the 2007 data based on persons, has not abated despite the recent strong improvement in the German labour market. These numbers imply a persistent, not just disinflationary, but deflationary effect

Figure 9



coming from German wage-setting (given the country's productivity trends). Taking the implicit ECB inflation target of 1.9% as a benchmark, the euro area average rate of ULC growth, at 1.0%, is almost a full percentage point lower. Spain, Greece and Portugal were only marginally higher than the target rate of inflation – although 2007 saw a major acceleration in Greece. Ireland and Slovenia, with substantially faster ULC growth, are very small members; Slovenia has only just joined the euro area and corrected sharply in 2007. In the aggregate, then, ULC growth has been disinflationary during the entire course of EMU, and remained so in 2006 and 2007 despite the tightening labour market. Wage growth has thus served to offset the upward pressures on inflation resulting from higher imported prices, notably for energy and recently food.

Figure 10

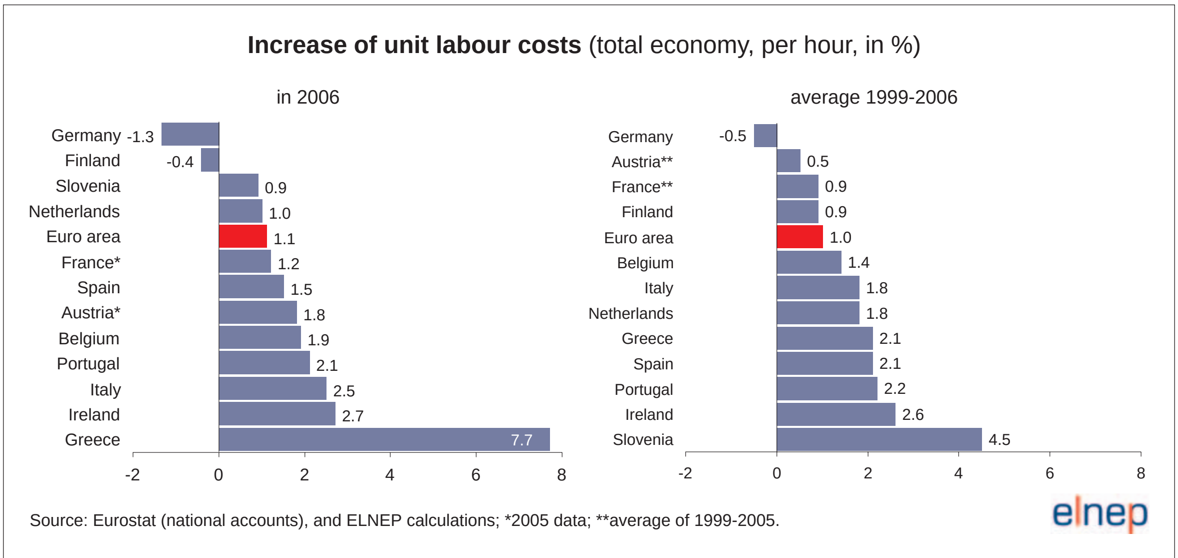
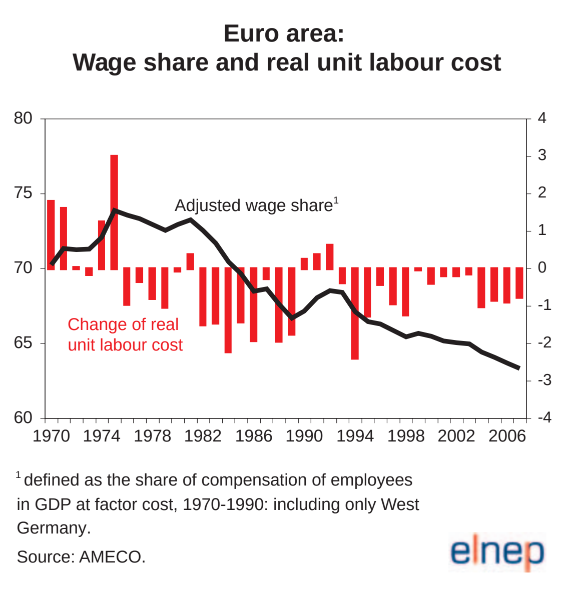


Figure 11



A consequence of this disinflationary wage policy coupled with above-target actual inflation can be seen in Figure 11. Unit labour costs measured in real terms (i.e. real unit labour costs, RULCs) have been negative, so that the share of national income going to labour has been declining. This marks a continuation of a longer-term trend. Since the start of EMU labour's share of income has dropped by – a further – 2.5 percentage points of GDP. It is about 7p.p. lower than in 1970 and more than 10 points of GDP below its high-point in the mid-1970s. This trend has given rise to a wide-ranging debate among international institutions and policymakers, the tenor of which is that steps must be taken to ensure that the 'fruits' of globalisation are shared more fairly. Doubts have also been cast on the informational content of the wage share (pointing, for instance, to the fact that working and retiree households also draw income from capital and to more technical issues relating to treatment of the income of the self-employed).[2] This debate cannot be entered into here. It should be pointed out, though, that the root cause of the declining wage share is the fact that wage increases have consistently lagged behind the sum of productivity and inflation. It is rather disingenuous of policymakers such as the OECD and the European Commission[3] that explicitly recommended wage growth lagging in this way (to 'create room' for job increases) to be surprised or concerned by the fact that the wage share has fallen so dramatically.

Alongside the overall rate of nominal ULC growth, Figure 9 raises the serious issue of competitiveness *within* the euro area. Countries with sustained ULC growth below the euro area average – especially Germany – have improved their competitiveness vis-à-vis the other members: within a monetary union, exchange rate movements are not available as a compensating mechanism. The mechanical counterpart of this is a loss of competitiveness among countries with above-average ULC growth. This is not necessarily a problem, if it represents a correction of previous imbalances. Also countries with a low price level may be expected to have faster ULC (and price) rises as part of a price-level convergence process. However, if sustained – and the figures are annual averages over a seven-year period – above-average ULC growth can cause a substantial loss of competitiveness.

[2] European Commission (2007) Employment in Europe Report 2007, Chapter 5: http://ec.europa.eu/employment_social/employment_analysis/employ_2007_en.htm

[3] In the so-called Delors Report: Growth, Competitiveness, Employment: The Challenges and Ways Forward into the 21st Century - White Paper, COM(93) 700, December 1993.

Indeed we see that over the life of EMU Germany's current account position has moved from a deficit of 1% to a huge surplus of 8% of GDP; meanwhile Spain has chalked up the largest current account deficit in the world as a share of GDP: 10% in 2007. Such competitive disequilibria are unsustainable in a monetary union. If competitive pressures do not lead to a correction EMU might collapse. Although there are some differences, countries such as Spain potentially face an 'Argentina scenario' in which boom quickly turns to bust, and the previously beneficial exchange rate peg (EMU membership) becomes a huge millstone around the economy's neck.

To avoid this and ensure balanced development within EMU, wage increases need to be oriented towards the medium-run rate of national productivity growth (plus an inflation component compatible with overall price stability). ELNEP has consistently argued for this.[4] It is important to note, however, that this does not mean – as many European policymakers seem to think – that all countries should emulate Germany: clearly not all countries can have below-average ULC growth. ULC increases that undershoot the average are as important to correct as countries that overshoot. In some countries oligopolistic market structures reduce price pressure on firms and encourage them to raise prices despite wage moderation: a sensible agenda of product market reforms may well be a useful adjunct to a balanced wage policy in such cases.

[4] See past reports available from www.elnep.org . See also Watt, A. (2007) 'The role of wage-setting in a growth strategy for Europe', P. Arestis, M. Baddeley and J. McCombie (eds.) Economic growth. New directions in theory and policy, Edward Elgar.

Productivity growth – a worrying slowdown

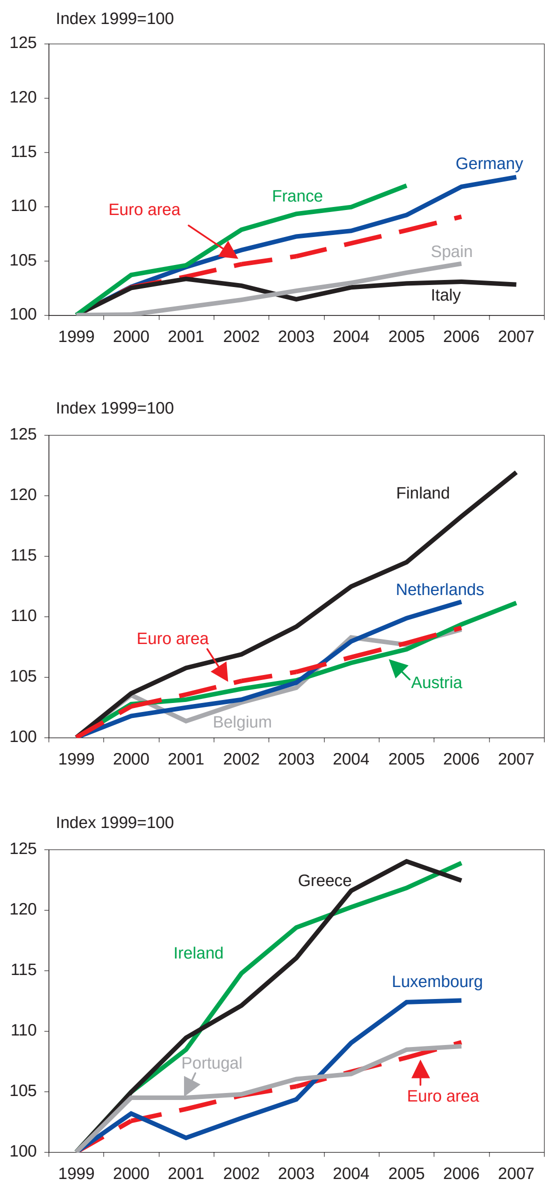
In a model of balanced economic development, productivity growth is the key driver of rising wages and living standards. Productivity growth cannot be decreed from on high, however. Productivity outcomes result from a complex and imperfectly understood mix of capital investment, education and training measures, efficient work organisation, input of modern technology, and workers' motivation and commitment. The Lisbon target of making Europe the most dynamic knowledge economy in the world calls for workplace re-engineering, aimed at changing European business into high-performance work organisations. A key – although not the sole – task of government policy is to set incentives in such a way as to encourage workers and investors to steadily raise productivity through these different channels.

Figure 12 shows hourly productivity trends in the euro area countries since 1999. The graph shows that, in 2006 each hour of work generated about 9% more in output (after allowing for price increases) than in 1999. This increase is 'available' for rising living standards or also to reduce working time and increase leisure.

The figure shows that most euro area countries are experiencing productivity growth quite close to the euro area average. Four countries have enjoyed remarkably fast productivity increases: Finland, Greece, Ireland and Slovenia. It would be tempting to treat this, in all but the first-mentioned case, as a typical 'catch-up' phenomenon: countries with a lower income level have

Figure 12

Hourly productivity (in %)



Source: Eurostat, ELNEP calculations.

more scope to raise productivity by increasing capital investment and benefit from sectoral change to high productivity sectors. Such a diagnosis is called into question, however, by the fact that the two countries with substantially below-average productivity growth are Italy and, above all, Spain.

The numbers suggest that, after an encouraging start, something occurred to drag Italian productivity seriously downwards. Spain, a potential 'catch-up country' seems to be on a structurally low productivity growth trajectory. What could explain these trends (which, while primarily an issue for the countries concerned, do serve to drag down the European average performance)? The boxes offer a tentative first answer.

In **Italy** a comparative examination of labour productivity performance shows a true collapse of the Italian international position: according to Eurostat estimates, in 1999 the Italian score in hourly productivity, measured in purchasing power parities, was 102 (100 being the EU15 average), while in 2006 it was 90. Very similar results are obtained whatever the measure of productivity.[5] This outcome is rooted in the negative macroeconomic interaction between a still insufficient competitiveness of the product market and, in the labour market, the combination of rapid growth of flexible jobs and persistent wage moderation, even in the face of an unemployment rate that has fallen beneath the European one. This negative interaction has led to an unwanted employment-productivity trade-off in a context of increasing rents and lost competitiveness.[6] The current Italian debate discusses the need to increase competitiveness in the sheltered sectors through a further liberalisation effort. Collective bargaining also has an important role to play. While the need to increase domestic demand by enhancing the purchasing power of wages and pensions through a one-off tax reduction has been repeatedly announced during the just-ended electoral campaign by the winning political party, social partners are discussing how to modify the architecture of the Italian wage bargaining system (the so-called '93 Protocol). The aim is to strengthen the role of collective bargaining as a stimulus to local wage bargaining, in the framework of a new social pact for productivity and growth, based on workplace reorganisation. The main items for discussion are the extension of industry-wide collective wage agreements with a duration of from two to three years, and the use of national agreements as a stimulus to (and at least temporary substitute for) local wage bargaining.

In **Spain** economic growth, unlike in Italy, has been rapid, but it has been based almost entirely on employment increases while productivity growth has been minimal. Such a growth regime logically has a limit: employment, especially in ageing countries like Spain, can not grow forever and immigration inflows or a larger female workforce can only postpone the stationary state. A low capital to labour ratio has not been the problem: the increase was not far below the EU15 average. In fact investment, not only in housing but also in plant and machinery, has been growing rather fast during this period. The major problem is that total factor productivity (TFP) growth, whose main determinant is technological progress, has been very low (less than a quarter of the EU15 average). The principal cause of stagnating productivity is the slow progress in adopting more efficient technologies. The R&D to GDP ratio is one of the smallest in the EU, below 50% of the most advanced countries. For years innovation has rested largely on foreign capital while domestic firms R&D expenditure has been always very low. The loss of the attractiveness of Spain for multinational firms during the past years, looking for greener pastures in emerging and eastern Europe countries, has aggravated the trend.

Regarding human capital, school enrolment in secondary and higher education is at comparable levels to other high developed countries, but low performing scholars (as OECD-PISA reports show) and low career-development incentives for researchers are clear pitfalls. Another major problem in this respect has been that, following labour markets deregulation policies during the 80s and 90s, firms have used and abused temporary contracts, making high work rotation a clear disincentive for training and further investment in human capital at the working place.

Last but not least, during the past boom in which the housing sector has reached more than 10% of GDP and where tourism and low-cost services have represented a high share of total GDP, the economic structure has shifted clearly towards less technological demanding activities. This shift towards low productivity growth sectors has been in part the consequence of high immigration inflows during the last years. Immigration has had a composition effect upon factor endowments towards a low skilled labour force, making the Spanish economy more inclined to specialise in sectors intensive in low skilled labour, with low wages and low productivity.

[5] See the EU-KLEMS Project site: http://www.euklems.net/.

[6] Tronti L. (2007), “The July Protocol and Economic Growth: The Chance Missed”, in Acocella N. and Leoni R. (eds.) (2007), Social Pacts, Employment and Growth, Physika-Verlag, Heidelberg, pp. 69-96.

This raises a wider and important issue. Earlier it was emphasised that (real) wage growth should be in line with productivity. However, causation must also be assumed to flow in the opposite direction, from wages to productivity. At the aggregate level, wage growth lagging behind the (initial) rate of productivity growth has the effect of pricing workers into work (provided macroeconomic policy ensures that aggregate demand growth is sufficiently strong). But this also changes, over an extended period, firms' mix of factor inputs. Other things equal they reduce the input of capital per unit of labour. As capital intensity is an important determinant of productivity this tends to slow the rate of productivity growth. At the level of the company, relatively cheaper labour means – on a standard microeconomic analysis – that firms have less reason to treat labour as a 'scarce good' to be deployed in production as efficiently as possible.

It seems likely that a central culprit in this regard is the decentralisation of collective bargaining. Increasingly firms in euro area countries have sought and found ways to permit them to deviate downwards from sectoral or national collective agreements. They have insisted on so-called 'opening clauses', have increased the extent of local or plant-level bargaining or have simply withdrawn altogether from sectoral-level bargaining institutions and mechanisms. Whereas in the past firms were forced to 'raise their game' by the pressure coming from centrally agreed wage increases (the so-called 'productivity whip'), firms have increasingly been able to force pliant company and plant-level worker representatives to make concessions on wages, avoiding the necessity of 'painful structural reforms' within the company.

This suggests – once again! – that the best wages policy is for balanced growth in step with productivity, and not a policy of wages lagging productivity, as, quite apart from possible negative impacts on aggregate demand, this risks forcing down the rate of productivity growth, and thus the benchmark for further wage increases. European trends suggest that this mechanism has been in play in recent years in Europe. The answer is a productivity-oriented wage norm and a return to collective bargaining that establishes a fixed price for labour across the relevant market.

Job quality and pay inequality[7]

The European Union's Lisbon Strategy was explicitly not just about raising the employment rate, but about 'more and better jobs', that is also about issues of the quality of employment. This is a broad field that cannot be done full justice to here. We consider two important issues in turn: the increased use of 'non-standard' employment contracts, and the problem of widening wage differentials and the issue of low pay. We conclude with an attempt to quantify progress (or regress) in job quality in the EU countries using a composite indicator of job quality.

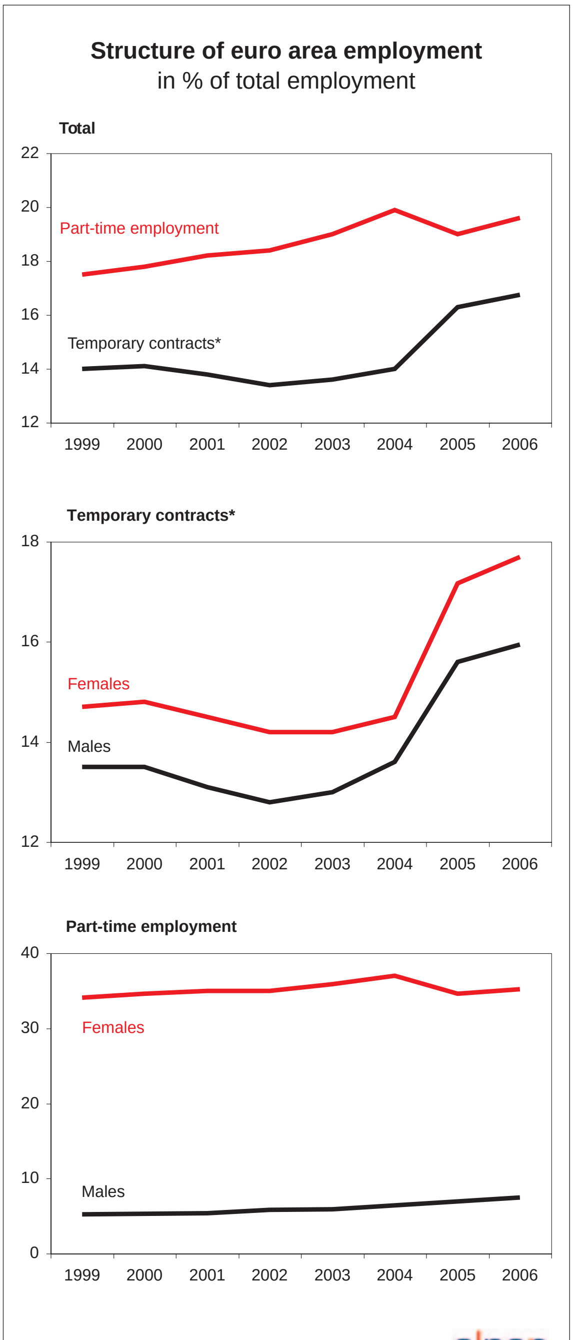
[7] Thanks to Wiemer Salverda, AIAS, for his contribution to this section.

Non-standard employment

Figure 13 shows the steady increase in both part-time and temporary contracts[8] in Europe: both have risen by more than 2 percentage points of employment since 1999. One in five workers in the euro area works part time. One in six has a temporary contract; the two groups overlap to a considerable extent. Temporary contracts, in particular, seem to be in part a cyclical phenomenon: the proportion working on such contracts declined when labour markets tightened in 2001, only to rise sharply as the period of economic stagnation lengthened; the recent improvement in labour markets and thus the bargaining position of workers does not, however (yet) seem to have reduced the incidence of temporary contracts, although the rate of growth has declined. By contrast the part-time share appears to be on a secular upward trend.

While women workers are slightly more likely than their male colleagues to be on fixed-term contracts, the gender divide is particularly stark in the area of part-time work: more than a third of women are employed part-time, making the term 'non-standard' inapplicable for this group. Part-time work remains a marginal phenomenon for men, although the male part-time share has risen by almost half since 1999. For the area as a whole there is no substantial difference in part-time shares between different female age groups (in some individual countries there are major differences, but they average out); part-time shares do vary with skill level, however, high-skilled women being less likely to take part-time work. By contrast fixed-term

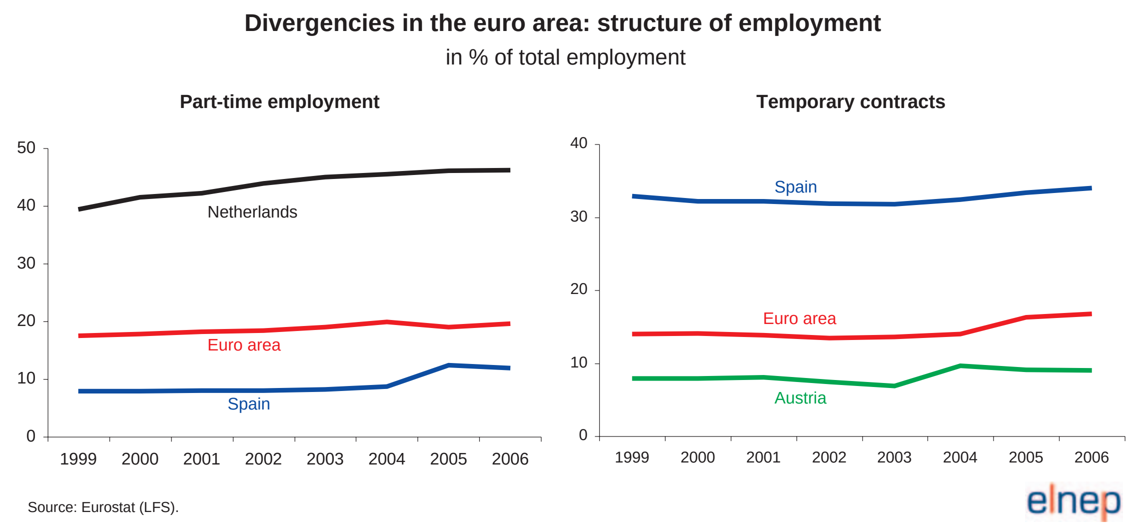
Figure 13



Source: Eurostat (LFS); * in % of total employees.

[8] We use the term 'temporary' here as it is that given in the Eurostat documentation. It should be made clear that it is not limited to those working for temporary employment agencies, but essentially consists of those whose employment duration is fixed in advance ('fixed-term contracts'), rather than being unlimited. Depending on the nature of temporary employment agencies, agency workers may in fact not be included in this definition (if their contracts with the temp agencies are 'permanent' contracts).

Figure 14



contracts are primarily a phenomenon of young workers.[9]

Figure 14 illustrates the extent of intra-EMU divergence regarding non-standard contracts. Interestingly, Spain, along with other southern European countries, still makes very little use of part-time work, but is the country of *precariedad*: around one in three workers lives with the insecurity of a fixed-term contract. The Netherlands is well known as the 'part-time economy': the part-time share continues to rise inexorably, and is set to reach 50% in the near future.

The issue of whether such contracts are chosen by workers, whether they are 'voluntary' or 'involuntary', is a thorny one. Survey responses need to be interpreted carefully and depend to a great extent on the range of responses offered: a key issue is whether (especially) women consider a part-time job that is taken to allow for child-care to be a 'voluntary' choice or not. Clearly this depends on the existence of collective or family-based alternatives. According to the European Labour Force Survey, around 30% of part-timers (more for men, less for women) explicitly stated that the main reason for working-part-time was that they 'could not find a full-time job'. Conversely around 17% stated explicitly that they did not want a full-time job. This leaves around half of the part-timers whose voluntary or involuntary status is debatable; particularly in the case of students financing studies and, above all, women working part-time, who would very possibly prefer a full-time job if adequate child-care facilities were available. While similar considerations apply in principle to those on fixed-term contracts, here the verdict of European workers is much less ambiguous: almost two-thirds of those working on fixed-term contracts explicitly state that they only do so because

[9] Further details on non-standard employment in Europe can be found in the ETUI-REHS Benchmarking Working Europe Report 2008: 33ff.. Available under: http://www.etui-rehs.org/research/Publications/Regular-publications/Benchmarking-Working-Europe/Benchmarking-Working-Europe-2008

permanent employment was not available (this is consistent with the cyclical pattern described above).

Wage inequality and low pay

Alongside the shift in 'functional' income distribution from wage-earners to capital-owners described earlier, widening income disparities between wage-earners have also been a worrying feature of recent years. New results from extensive research on low-wage employment in Europe and the United States show a rapid increase in the incidence of low pay. A number of western European countries, most notably Germany, have increasingly taken on an 'Anglo-Saxon' character in terms of pay inequality, while others – especially Denmark – have stabilised the low pay incidence at comparatively low levels.

Russell Sage has just published a series of country monographs[10] on the situation of low-wage work in Denmark, France, Germany, the Netherlands and the UK, presenting the results of a four-year research project initiated by the US–based foundation of the same name.

Five leading research institutes[11] have taken stock of the nature and evolution of low pay in their countries and performed in-depth case studies of low-wage occupations in 200 establishments in five industries: retail trade, hotels, call centres, food processing and hospitals. A number of very interesting results were found:

- Germany – and to a lesser extent the Netherlands – have registered a strong increase to levels of low pay comparable to the UK and US;
- both the lowest level, in Denmark, and the highest level (in the US) have been remarkably stable over recent decades;
- the quality of working conditions of the low-wage jobs as such is not always better in Europe, but the jobs' social conditions – health care, paid holidays, etc. – certainly are;
- people move out of low pay more easily when the incidence in the country is lower.

[10] See www.russellsage.org/publications: Country monographs on *low-wage work for Denmark, Franc, Germany, The Netherlands and the United Kingdom*.

[11] Århus School of Business **ASB**; Université Paris-I, Université Paris-X and Ecole Normale Supérieure ENS, Paris; Institut Arbeit und Qualifikation **IAQ**, Duisburg-Essen; Amsterdam Institute for Advanced Labour Studies **AIAS**, Amsterdam and **STZ** Consultancy, Eindhoven; National Institute for Economic and Social Research **NIESR**, London and ESRC Centre on Skills, Knowledge and Organisational Perform **SKOPE**, Oxford/Cardiff.

Percentage of employees being low paid*, 2003-2005

Denmark	France	Germany	Netherlands	United Kingdom	United States
8.5	11.1	22.7	17.6	21.7	25.0

* Earning less than two-third of the median hourly wage.
In addition, France, Germany, the Netherlands and the UK have significantly more self-employed in the low-earning parts of the economy than Denmark and the US.

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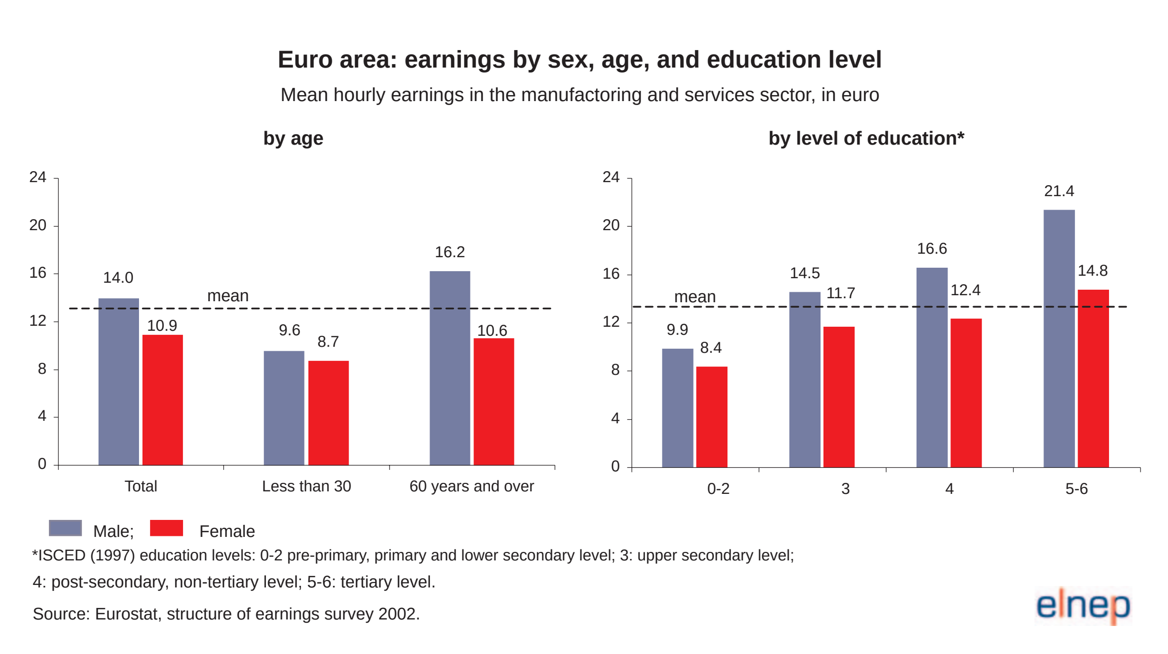
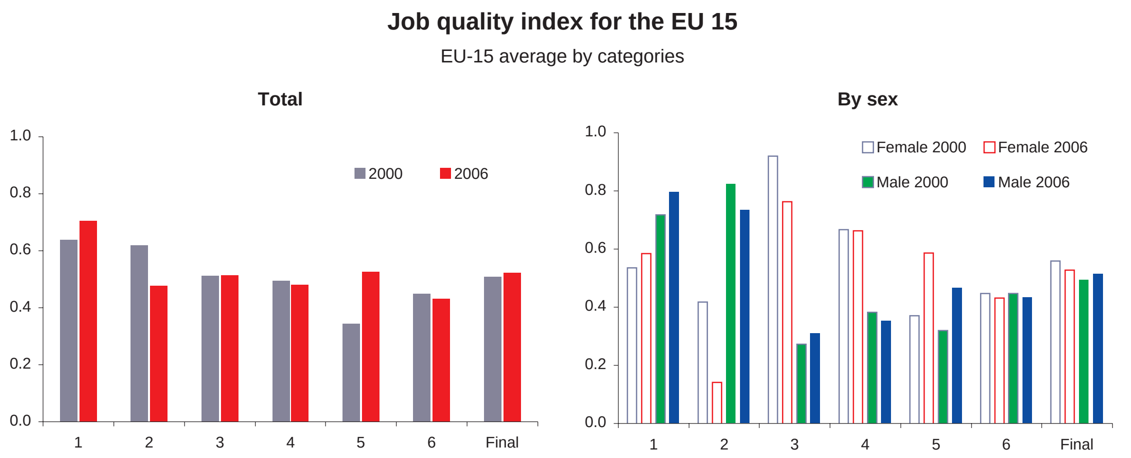
Figure 15



These results have several important implications. First, the main differences in low pay are now found within the EU and not so much between Europe and the US. Denmark, for instance, is setting an important example and there are no good reasons why other EU countries could not follow 'best-practice' countries. Second, the stable but very different incidence of low pay in the US and Denmark – while employment rates are similar, and unemployment much lower in the latter – throws up the question if labour-market institutions can really be blamed for unemployment and unemployment growth. Third, the growing mass of the low paid in Germany seems to request improved labour protection by a minimum wage or collective agreements. Last but not least, social security provided to all, and thus available to the low paid, in Europe deserves support and protection to avoid in-work poverty US-style.

As can be seen from Figure 15, pay inequality has important gender, age and skill dimensions. According to figures from the EU Structure of earnings survey, in 2002 the overall gender pay gap was a substantial 22% (per hour, so not allowing for gender differences in working hours). It is noteworthy that the differences is rather small for younger workers, but rises to around 50% for older ones: this clearly indicates the wage penalty of women's de facto greater responsibility for tasks outside paid employment (child-care, housework). More generally the age effect is substantial: despite the higher (formal) skills of younger cohorts, those over 60 earn around half as much again per hour compared with those under 30. The second panel shows that 'education pays' – especially for men. Men with the highest formal education levels earn more than twice as much per hour as their low-skill counterparts; the skill premium is considerably less pronounced for women.

Figure 16



*1: Wages; 2: Non-standard forms of employment; 3: WLB and working time; 4: Working conditions; 5: Skills and career development; 6: Collective interest representation

Source: ETUI calculations, see Leschke/Watt/Finn (2008).

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Assessing job quality

Job quality is clearly a multi-facetted phenomenon. In order to assess whether Europe is indeed creating 'better' as well as 'more' jobs, what is needed is an indicator of job quality that is comprehensive, comparable, European in scope and timely. The ETUI research department has sought to contribute to this aim by creating a composite European Job Quality Index.[12]

The following provides a brief overview of the preliminary results for the EU15, comparing data for 2000 and the most recent year for which data was available (which for different indicators was 2005-7). The EU15 JQI consists of a total of fifteen different indicators (some of which are themselves composites) which are weighted and collated into six sub-indices. These are: wages, non-standard forms of employment, work-life balance/working time, working conditions, skills and career development, and collective interest representation. The data for these different indicators – which are collated separately for 'total' and for men and women – are normalised in such a way that the worst-performing country gets a score of zero, the best performer one. By using the best and worst scores for 'total' in 2000 to normalise the figures for 2005-7, it is possible to assess whether countries (and the EU15 as a whole) have improved or declined in terms of job quality along the different dimensions, to rank countries in each year, and also to bring out gender differences. The JQI results for the EU15 are presented in Figure 16, while Figure 17 indicates the country rankings in 2000 and 2005-7. In both graphs higher values indicate higher job quality. Overall the JQI paints a mixed picture as to how job quality has developed in the different dimensions.

[12] Work on the JQI is on-going. Details on the construction of the JQI can be found in a working paper that can be downloaded from: http://www.etui-rehs.org/research/activities/Employment-and-social-policies/Reports-and-discussion-papers. The limitations of the JQI caused primarily by data constraints are set out in detail there. A slightly different index, to be updated annually, is also being calculated for the EU27.

- Quality along the ‘wages’ dimension – which considers real wages at purchasing power parities and an in-work poverty measure – has improved, as might be expected. However, a number of countries (e.g. Portugal, Spain) experienced a decline in their score, reflecting stagnant or even declining purchasing power of average wages and/or an increase in the risk of in-work poverty. There is a roughly parallel improvement for both men and women in the EU15 as a whole, maintaining the substantial gender pay gap.

- We see a significant deterioration in terms of the incidence of non-standard forms of employment (involuntary part-time and temporary employment), reflecting in particular an increase in the proportion of part-timers reporting that they actually wanted a full-time job, coupled with a smaller rise in the overall part-time share; the impact of the rise in temporary work is less pronounced. The figures confirm the well-known crass gender gap in the incidence of involuntary non-standard contracts, and the gender gap has widened over time.

- There has been little overall change in the sub-index work-life balance and working time. This indicator reveals a major gender gap, suggesting that *per se* women’s paid employment offers greater compatibility with other areas of life. Of course the prime driver of this is women’s greater *de facto* responsibility for non-work areas such as child and elderly care. Moreover, the job quality decline was marked for women, whereas men experienced an improvement.

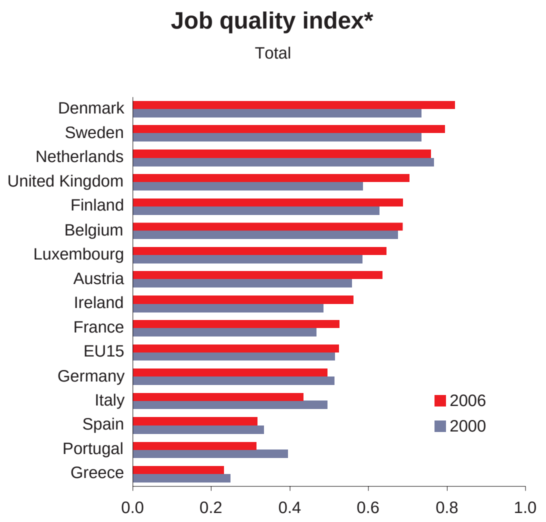
- A rather similar picture emerges for ‘working conditions’, which pools a whole series of reported physical job characteristics, work autonomy and stress, and also health and safety. Perhaps surprisingly in view of the shift from industry to services, there is actually a slight overall decline in this index. Again, as defined here, there is a substantial gender gap in women’s favour, reflecting notably sectoral segmentation in most countries.

- A welcome development is the overall improvement in the index for skill and career development (although data limitations meant that the comparison is based on a single indicator, the proportion of adults in education training, which may conceal changes in training duration and quality). Taken at face value it suggests that the policy recommendation for more life-long learning is having some effect.

- The indicator of collective interest representation (for which no gender disaggregation was possible) indicates a decline over time, albeit a small one, reflecting the fall in unionisation rates in most European countries.

It is difficult, of course, to weigh the importance of these sub-indices in any plausible way. The ‘final JQI’, is simply the unweighted average of the six sub-indices and points to an – almost imperceptible – improvement in overall job quality between 2000 and 2005-7 in the EU15. As is clear from the graph, this reflects a mix of improvements in some and set-backs in other areas. If one sets aside wages, which might be considered to have a ‘natural’ tendency to rise on average, the trend

Figure 17



*The higher the index value, the better are job quality/working conditions.

Source: ETUI calculations, see Leschke/Watt/Finn (2008).

appears on balance to be towards declining job quality. Whatever the weaknesses of the JQI as an indicator, even a cautious interpretation would be that the EU15 countries are, on average, not clearly moving towards 'better jobs'. The gender differences in the different sub-indices are substantial, so the fact that there is little gender difference in the overall job quality index is hard to interpret meaningfully. Tentatively, though, the indicator suggests a slight closing of the gender gap in terms of job quality (although this, too, is sensitive to the relative importance given to the sub-indices).

Figure 17 shows the country rankings of this overall JQI in the two years. The ranking on the most recent data reveals high scores for the two Scandinavian countries Denmark and Sweden; the other Nordic country, Finland, also performs well. Adding the UK, in fourth place, to Denmark and Sweden, the three non-euro area members clearly outperform those in the common currency area. It is the southern European countries that, on this measure, perform least well in offering high quality jobs.

It is noteworthy that the countries towards the top of the index tend to have low unemployment rates, with Belgium as an exception, while conversely those countries that the JQI suggests have a problem with job quality are amongst those with the highest unemployment rates. It is surely not the whole story, but this does suggest that lower unemployment has the additional indirect beneficial effect of strengthening the bargaining position of employed workers and, other things equal, forcing employers to offer their employees (more) decent work.

What is rather worrying is the trend over time in the high and low performance countries, against the background of the more or less constant figure for the EU15. Almost all of those countries with good performance in 2000 saw a further improvement in subsequent years, whereas the poor performers suffered a decline in their JQI (particularly strongly in Germany and Italy). This suggests a widening of differentials within (western) Europe, in terms of the aspects of job quality captured by the index.

Conclusion

In many important senses the euro area labour market performs better than its widely held reputation would suggest. Most notably, job growth has been strong, especially for women, and unemployment, although still higher than in the US, has fallen markedly. Europe has indeed created ‘more jobs’. However, there are a number of serious issues in the area of ‘job quality’ in the broad sense. Real wage growth has been sluggish and pay inequality has risen. The use of non-standard contracts (not freely chosen by workers) has grown steadily. The rate of labour productivity growth is much too low.

This report has suggested that these developments may be linked. It seems that returning to pay developments that are oriented towards medium-run productivity growth would be an important step towards raising workers’ living standards, would help stop the trend to greater inequality, but also serve to stimulate the rate of labour productivity growth on which, ultimately, rising living standards depend.

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