

EMCO meeting, 12 November 2009
Speech by Lorenzo Codogno
on “Labour market policies amid the crisis: the EPC view”

I would like to thank the Employment Committee for inviting the Economic Policy Committee to offer its views on the consequences of the crisis on growth and jobs policies.

The functioning of the European labour markets is a matter of great importance for the Economic Policy Committee. This year, with the situation in labour markets deteriorating considerably, labour market discussions gained an even more important role.

With the intensification of the financial crisis in mid-September 2008, we knew we were on the brink of a job crisis. We knew that a rise in unemployment was inevitable, but we also knew that much of the developments depends on our capacity to respond to the challenge.

Europe has taken rapid and decisive action in responding to the crisis with the European Economy Recovery Plan. And Member States, overall, have put significant emphasis on employment in designing their recovery packages.

Member States have focused on three broad types of priorities:

- ensuring rapid re-integration into the labour market by improving job placement mechanisms and investing in lifelong learning, in order to increase the employability of those hit by the crisis;
- maintaining existing jobs through the use of short-time working allowances, reduced social security contributions, and wage subsidies; and
- supporting the most vulnerable with more generous unemployment benefits, higher minimum wage and family allowances, with tax rebates or exemptions, and with measures against over-indebtedness.

The Economic Policy Committee highlighted at that time that measures such as extending the coverage or levels of unemployment benefits, reinforcing other social benefits and deploying large scale short-time work and part-time employment measures, were desirable responses so long as they were time-limited.

Other employment measures more consistent with the long-term structural reform agenda relate to supporting activation and promoting re-integration in the labour markets to facilitate transitions to new jobs. These measures were all very welcome and timely.

Although it is hard to quantify their precise impact on labour market outcomes, these measures seem to have contained the rise in unemployment and have alleviated social hardship to some extent in most Member States. In this sense Member States have generally been relatively successful in achieving our first task - an acute job crisis has so far been avoided in most of the Member States.

It is also fair to say that labour market reforms implemented in recent years have contributed to the good performance in labour markets recorded before the crisis, with a high level of job creation, low levels of unemployment, higher labour market participation, and contributed to increasing the resilience and flexibility of European labour markets.

One striking feature of this crisis is the heterogeneity in unemployment developments across countries. For example, in Spain the unemployment, since pre-crisis lows, increased around 11 percentage points. In Germany this value is less than 1 percentage point and in the Netherlands and Italy just slightly above 1 percentage point. This may reflect differences in the functioning of national labour markets, different sectoral employment composition and different levels of flexibility of employment contracts. In the case

of Spain, for example, most of workers affected so far were under temporary contracts.

Also, different policy responses can partly explain heterogeneity. Policy responses resulted in very different degrees of labour hoarding through adjustment of the number of hours of work per employee and subsidies to wages. The adjustment of hours worked allowed companies to hoard labour and protect human capital needed for the period after the crisis. Effectiveness of these measures can only be assessed over time and depends on a number of factors as, for instance, how they are able to facilitate sectoral reallocation.

Unemployment also affected social groups differently. Temporary and less experienced workers are among the most affected by the crisis. This can raise additional social problems as these workers also have less unemployment insurance coverage.

Let me now move to the current situation and the EPC view regarding structural reform priorities. The recession may be over, but the impact of the crisis is here to stay for a while. We know that labour markets usually react to GDP developments with a time lag of about 3 quarters. But how persistent will these effects be is difficult to say. Much will also depend on the implementation of proper exit

strategies on the fiscal and monetary side, and the strengthening of the reform process.

Moreover, this crisis may have had an impact on potential output and potential output growth. This reinforces the need for structural reforms of product and labour markets which must play an integral part of exit strategies, to help growth rates recover, reduce unemployment, smooth the necessary adjustment, and help restore public finances to sound positions.

Currently, there are two major risks facing labour markets: the risk of jobless growth and the risk of hysteresis.

The risk of jobless growth stems from the current size of labour hoarding, the macroeconomic uncertainty, internal reorganisation of firms, and sector reallocation which may render some skills obsolete. The risk of hysteresis may also arise from skill deterioration and from increased duration of unemployment. It will take some time until employment recovers to pre-crisis levels. The shape of the recovery will be key for the adjustment process.

Unfortunately, past experience is not reassuring. Empirical evidence suggests an increased risk of unemployment becoming persistent following a financial crisis.

In addition, the European labour market needs to continue to address the combined long-term challenges arising from demographic change, globalisation and technological progress.

With this in mind, the Economic Policy Committee considers that time has come to move beyond short-term demand management to address the effects of the crisis. Labour market reforms are especially important to facilitate a swift transfer of workers to new activities and prevent the increase in unemployment from having permanent effects.

It is the Committee view that action should be taken on the following areas as a matter of priority, as highlighted by Finance Ministers at their latest Eurogroup meeting:

- addressing segmented labour markets, through reforms that focus on securing the employability of workers rather than on saving specific jobs and firms, while providing adequate income support where necessary.
- Introducing, in parallel, ambitious and effective activation and training measures aiming at improving skills, along with increased capacity and cost-effectiveness of public employment services.

- facilitating transitions, also through measures supporting labour mobility across occupations and regions, also by reducing benefit dependency and improving activation.
- allowing relative wage flexibility and wage developments in line with productivity, competitiveness and local labour market conditions, especially for countries with accumulated losses in external competitiveness.

Finally, let me remind that the Economic Policy Committee highlights the importance of raising the effective retirement age in order to quickly return to sustainable public finances and increase labour supply.

To sum up, finding the proper mix of policies and addressing all relevant economic and social issues will be challenging but still within the reach of policymaking.