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ETUC Conference on 21 March: « labour market reforms and macroeconomic policies »

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Panel discussion with Commissioner Joaquin Almunia, Pervenche Berès, Chair of EP Economic and Monetary Affairs Committee, and Reiner Hoffmann, ETUC Deputy General Secretary

I. Massive unemployment has little to do with macroeconomic policies…

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- High unemployment in Europe emerged from the interaction of economic shocks and institutional rigidities, which amplified their negative effects.
- The exact contribution of shocks (oil shocks, productivity slowdown, decline in unskilled labour demand) and institutions (evolution of labour laws, social benefit systems, taxation and wage bargaining structures) is unclear from literature.
- What is clear is that certain institutional settings in certain countries have been particularly detrimental

⇒ This emphasises the complexity of interactions and the need for each country to devise its own package of labour reforms

⇒ There is no magic recipe but some general recommendations can be formulated

What are the main policy priorities?

- Improve work incentives (better design of tax and benefit systems)
- Focus more on activation strategies, job-search assistance
- Adapt initial education and improve life-long learning and employability => Employers must play an active role here
- Increase flexibility, and not only for specific segments of the labour market
- Promote geographical and occupational mobility
- Keep wage developments consistent with trend productivity and the maintenance of price stability

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What has been achieved so far?

- There has been some progress over the last decade. Structural unemployment has declined and labour participation increased. This has made a positive contribution to growth.
- Improvements have resulted from wage moderation, targeted reductions in non-wage labour costs and better activation strategies (work incentives and training)
- But progress is largely insufficient. 20 million unemployed in Europe is unacceptable and participation is too low, especially among older workers.

⇒ Future efforts will need to concentrate on increasing flexibility, reducing disencentives from taxation, and ensuring a better match of labour market needs through education, training for the unemployed and lifelong learning.

What could be the benefits of future labour market reforms?

- High unemployment remains the leading preoccupation for many Europeans (1st position in Eurobarometer) and it creates negative responses to change. Progress towards reducing barriers to job creation could create a virtuous cycle of reform
- In recent years, there has been weak domestic demand partly related to high precautionary savings. Prospects of a sustained improvement in the labour market could release significant pent-up spending, which would boost economic growth and employment.
- Better match between firms' employment needs and the supply of skills available on the market will help Europe benefit more from globalisation and technological changes

II. Are labour market reforms enough to tackle Europe's growth deficit? No

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- Tendency towards lower growth in Europe is captured by a dismal productivity performance over the last decade (LP per hour: 85-95 => 95-04: EU : 2.3 => 1.5, US : 1.3 => 2.2).

- Consequences are pervasive: weak productivity growth is constraining wage growth and discourages firms from investing in Europe => this has been a crucial constraint on domestic demand

- The productivity slowdown has been partly related to the re-integration of low-skilled workers and long-term unemployed in the labour market

- But this trade-off between labour market improvements and low productivity growth is only half of the story. The second half relates to a loss of competitiveness, as visible in a trend slowdown in Total Factor Productivity growth (TFP: 85-95 => 95-04: 1.1 => 0.7)

⇒ Labour market reforms need to be complemented by measures to develop a business environment more conducive to growth and innovation

III Can the macro policy framework be more supportive of the reform agenda ?

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- **The issue…**
  - Reform can involve short-term cost, distributive effects (especially labour market reforms) => risk of status quo bias due to political economy constraints
  - Recent OECD and IMF studies show that the reform momentum has slowed down since EMU, mainly in large euro area countries (Elmeskov (2005, OECD) Debrun (2003, IMF)). Macro framework has removed some “sticks” and provides few “carrots”

- **New SGP introduces welcome flexibility to accommodate reform agendas**
  - benefits of structural reforms on public finances could be frontloaded and justify a different path of fiscal consolidation

  But:
  - Excessive deficits in countries most in need of reforms imply limited flexibility today. 3% deficit in a recovery would be acceptable if reform us pursued through.
  - Public money is no guarantee for success. Countries with more rapid labour market improvements have also been those consolidating public finances
  - High budget deficits will hamper rather than help employment prospects in an ageing society
  - The key priority: redeploy public expenditures where it has most significant effects on growth and jobs (education, innovation and human capital)

Is there place for a more accommodative monetary policy ?

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- **ECB should also be ready to accompany widespread reforms**
  - UNICE agrees that price stability is a prerequisite for sustainable growth
  - UNICE agrees that the prevailing low interest rates are growth-supportive
  - But UNICE does not consider that more interest rate hikes would be opportune in the short term. Our recent forecasts point to a very fragile recovery and do not reveal significant risks of second round effects
  - ECB could more explicitly accept that, without prejudice to price stability, it is also committed to support policies promoting high sustainable growth and well functioning labour markets
  - ECB should point out that vigourous reforms could be accompanied by supportive monetary conditions

But:

- The euro area is not one but 12 economies: policy response cannot be tailored for one specific country => need a simultaneous reform effort across countries

⇒ **Commission and Eurogroup need to think of ways to improve reform coordination and surveillance at euro area level**