



## **Employers' Analysis of the Key Challenges Facing Europe's Labour Markets**

### **Introduction**

The commitment of the European social partners to undertake a joint analysis of the key challenges facing Europe's labour markets is without doubt ambitious. If the exercise is to be worthwhile it needs to be carried out with the objective of trying to make a serious contribution to the improvement of labour markets in Europe. The social partners need to be clear about the key indicators of effective labour markets, particularly increased employment rates, more competitive economies and enhanced social cohesion. We all know that, with 17 million unemployed, ever tougher external competition and clear signs in many EU countries of social stresses and strains, there is much to be done. And we all also know that trends in demography, globalisation and the rate of technological change clearly indicate that the challenges on the near horizon will be even greater than those we face today.

This position paper from the Employers (UNICE, CEEP and UEAPME) first focuses on the weak performance of the European economy and how this is linked to some key characteristics of its labour markets. It then identifies six policy priorities to ensure that labour market institutions become an instrument for, rather than a barrier to, reaching high sustainable growth and full employment.

### **Why is Europe lagging behind in the global economy?**

Europe is increasingly lagging behind in the global economy. Over the last decade, potential output growth has been on a declining trend in Europe. This contrasts sharply with the stronger performance of other developed economies. Europe's relative decline reflects, among other factors, the persistence of major structural impediments on both product and labour markets. Obstacles preventing companies from adapting, innovating and employing people under fast-changing conditions translate into insufficient productivity growth and high structural unemployment.

Rising labour force participation and declining unemployment since the mid-1990s have made a positive but modest contribution to real GDP growth. However, at the same time, poor productivity performance has dragged our potential growth down. Yet, the experience of the United States and of some Member States shows that there are ways to avoid the negative trade-off between more inclusive labour markets and strong productivity growth in which most of Europe is trapped.

The inadequate functioning of some national labour markets plays a crucial role in the difficulties that the European economy is currently facing. Outdated and unnecessarily rigid

labour regulations hamper the creation and growth of new businesses, curb productivity growth and encourage undeclared work. High taxation, excessive non-wage labour costs, lack of wage differentiation and limited geographical and occupational mobility increase the adjustment costs associated with globalisation and technological innovations, thereby reducing their benefits. Hours worked per person employed continue to decline dangerously in the face of demographic change. Undeclared work creates unfair competition in labour-intensive sectors.

Europe's poor employment record is not the result of demand deficiency. Boosting employment growth in Europe requires structural labour market reforms, to remove the obstacles preventing job creation. At the same time, in order to reap the full benefit of labour market reforms, these must be complemented by measures aimed at stimulating business investment, innovation and technological progress. Creating a business-friendly environment is essential for job creation. In addition, measures must be taken to ensure a better match between the skills demanded in the modern workplace and supply. Similarly the institutions and policies aimed at the active integration of excluded groups from the labour market must be fit for purpose. Steps must be taken to avoid long-term exclusion from the labour market, which is not only a key factor behind social exclusion, but is also costly for individuals and society as a whole.

These goals can be more easily reached in a favourable macro-economic environment. An effective macro-economic policy framework can contribute to this, by providing stable and predictable medium-term prospects. This can be seen as a pre-condition to foster the development of human capital investment and innovation by private companies. Moreover, when the necessary budgetary margins are put in place, governments are able to contribute to better functioning labour markets and more competitive economies, through active labour market policies, R&D investment and infrastructures.

High-quality public services play an important role in the development of effective labour markets and competitive economies. Cost-effective social protection systems; efficient public employment services, the quality of education in publicly-funded schools and universities; and the effectiveness of public networks are all examples of how public services can underpin the competitiveness of the economy. There is a role for both public and private sectors in the provision of public services, with decisions being taken as close as possible to the point of delivery and underpinned by cost-effective private or public investments.

The process of economic transformation necessary to face up the challenges of globalisation and technological change coincides with a radical demographic shift. Europe's workforce is ageing and will soon start shrinking. The fact that people are living longer is a great achievement but it also alters the functioning of our economies. What should be a strength becomes a weakness if we do not take the necessary measures to ensure the sustainability of Europe's welfare systems. Time is running out. The longer we wait, the more difficult and painful it will become. Until 2017, rising employment rates could offset the decline in working-age population but after that both the size of the working-age population and the number of persons employed will be on a downward trend. EU governments must reduce national debts and achieve budget surpluses now in order to prepare for the financing of age-related expenditures in the future. Raising the retirement age is inevitable if pension systems are to be sustainable but much more needs to be done to make active ageing a reality while ensuring at the same time the successful integration of young people into the labour market.

A comprehensive set of policy action across a broad front will be needed to alleviate the economic implications arising from demographic ageing, globalisation and technological change. The detailed measures must take account of the specificities of each country and can only be decided in the Member States. However, there are common weaknesses in

Europe's labour markets and UNICE, UEAPME and CEEP would like to underline six policy priorities on which to focus to improve the functioning of Europe's labour markets:

- Improving the business environment to foster innovation and job creation;
- Turning job security into employment security;
- Ensuring that labour costs do not restrict labour demand;
- Designing tax and social protection systems so as to improve work incentives and increase labour supply;
- Ensuring a better match of labour demand and supply through lifelong learning and increased geographical and professional mobility;
- Creating inclusive labour markets integrating disadvantaged groups and developing pathways to better work.

## **1. Improving the business environment to foster innovation and job creation**

Creating a better and more supportive business environment that stimulates entrepreneurship and innovation is key to boost job creation. Levels of entrepreneurial activity vary widely across the EU but are systematically lower than in the USA. In 2004, entrepreneurial activity levels in the EU ranged from 2.6% in Slovenia to 8.8% in Poland. The level stood at 6.3% in the UK. This compares with 11.3% in the USA.

An essential element to fostering an entrepreneurial mindset and releasing Europe's entrepreneurial potential is through appropriate education but Member States must also put in place the right regulatory, financial and administrative conditions in order to facilitate the creation and expansion of businesses.

Simplifying regulatory and administrative procedures will be particularly beneficial for SMEs. Fully applying the Commission's approach of "Think small first" by carrying out, before revising existing legislation or taking new initiatives, an in-depth impact assessment especially concerning very small enterprises, is essential. Advisory services and one-stop shops can play a useful role in facilitating business start-ups. Better access to finance is also needed.

At the EU level, further market integration by completing the internal market is essential to foster economic growth, job creation and innovation. Internal market barriers for SMEs need to be removed as a matter of priority in order to enable them to take full advantage of the European Single Market.

The ability of businesses to grow and create jobs is also dependent on their capacity to innovate. To complement a more supportive business environment, Europe therefore needs a strong and coherent innovation policy.

## **2. Turning job security into employment security**

Recent studies and surveys show that people do not feel secure because they are safeguarded by employment legislation in place but because it is relatively easy to find a new job. In today's labour markets, security is not about preserving a job for life. It is about making sure that workers possess the necessary skills and flexibility to adapt to changes and grasp new employment opportunities.

The so-called flexicurity approach requires comprehensive national strategies with the right mix of economic and social measures to foster job creation and help people to maximise their chances on the labour market. This means

- creating an overall environment favourable to investment and in particular pursuing sound macro-economic policies,
- flexible labour law with job protection legislation which facilitates recruitment and making available various types of employment contracts to answer different working time needs of companies and workers and a commitment to fight undeclared work,
- putting into place effective active labour market policies, which presupposes that the necessary budgetary margins have been created to allow such an investment, and
- having an employment-friendly social protection system and in particular an unemployment insurance which links rights and obligations for the unemployed as opposed to giving unconditional passive income support.

### **3. Ensuring that labour costs do not restrict labour demand**

As high non-wage labour costs have an important negative effect on labour demand and employment levels, creating the conditions for a reduction of non-wage labour costs such as social security contributions is indispensable. Hence the importance of introducing reforms of pensions matching the scale of the demographic ageing challenge.

Wage formation takes a central role in the functioning of labour markets and has a strong influence on employment creation and therefore economic growth. Wage developments have to be aligned with productivity developments, not only at aggregate level but also across various segments of the labour market. Hence the importance of ensuring sufficient wages differentiation to reduce wage inertia and the impact of negative economic shocks. Furthermore, it is essential that wage negotiations not only reflect insiders' preferences but bear in mind outsiders' interests. Wage-setting must be responsive to the aim of integrating more people on the labour market.

### **4. Designing tax and social protection systems so as to improve work incentives and increase labour supply**

Tax and benefits systems have a significant effect on labour supply and serious financial disincentives still exist in most parts of Europe for people to enter, remain and progress in the labour market. In addition, they are an important factor behind undeclared work. Social benefit systems need to be designed so that they provide adequate income support while not discouraging work. Increasing the gap between in-work and out-of-work income, especially at the lower end of the wage scale where unemployment traps are particularly strong remains a priority.

Another crucial issue given the prospect of the ageing and shrinking work force, is to induce older workers to remain longer on the labour market and discourage early retirement. This requires strengthening the relationship between pensions rights and the number of years of contribution, notably for high income earners.

### **5. Ensuring a better match of labour market demand and supply through lifelong learning and increased geographical and professional mobility**

Today, around 150 million EU citizens have not achieved a basic level of secondary education and only 20% of working-age population attain tertiary education compared with 39% in the USA. Moreover, the average EU adult is significantly less educated than counterparts in other industrialised countries: he or she has spent some two years less studying than the average American citizen and one year less than the Japanese. In addition, the emerging economies are rapidly catching up in terms of skill endowment.

Demographic projections, remaining competitive in an increasingly knowledge-based world economy and the need to improve productivity to foster sustainable growth and jobs are

three mutually reinforcing reasons to better develop and manage Europe's human capital. Europe needs to increase both educational attainment levels and improve access to lifelong learning. Together with the need to invest more, a stronger effort needs to be made to increase the effectiveness of spending.

To help to overcome the current unnecessary trade-off between more inclusive labour markets and high productivity growth, Member States need to :

- ensure that individuals acquire the necessary basic skills before leaving education systems;
- facilitate companies investment in skills development;
- encourage individuals to take responsibility for upgrading their competences throughout their working lives;
- ensure that educational or training outcomes match the needs of big, small and medium-sized enterprises in order to improve the match of labour supply and demand.

The EU has persistently lower geographical labour mobility than the USA. Inter-state mobility of nationals is almost five times higher in USA than in the EU (5.9% compared with 1.2%). Geographical mobility within EU Member States is also relatively low, except in the Nordic countries where around 40% of the labour force have lived in a different region or country. In addition, Europe also suffers from low levels of occupational mobility. On average almost 40% of European workers has been with the same employer for over 10 years.

In recent years, five of the Member States with the highest overall levels of mobility have also registered strong economic growth and low – or significantly reduced - unemployment rates.<sup>1</sup> This points to a relationship between mobility levels and strong economic and labour market performance. That is why obstacles to mobility should be removed.

In terms of cross-border mobility, the measures to be taken are:

- applying rigorously EU provisions relating to free movement of workers and completing the Internal Market;
- avoiding double taxation of supplementary pensions and eliminating remaining discrimination on the grounds of nationality in national tax rules on supplementary pensions;
- improving the transparency of education and training qualifications at EU level;
- facilitating cross-border mobility of third-country nationals already legally residing and working in a Member State.

Workers can also be discouraged from moving within their own country by the lack of adequate transport infrastructure, rigidities in housing markets, etc. Hence the need to look at how to address those barriers in the countries concerned.

The causes of weak occupational mobility vary. They need to be addressed through general labour market measures such as lifelong learning, active labour market policies, support from employment agencies, development of smooth transition pathways between different working statuses, etc.

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<sup>1</sup> These five countries are Sweden, Denmark, Finland, Ireland and the UK.

## **6. Creating inclusive labour markets integrating disadvantaged groups and developing pathways to better work**

In 2003, the EU-25 counted approximately 31.7 million people (or 8.5% of the population of working age) who were excluded from the labour market.<sup>2</sup> Labour market exclusion brings with it not only significant individual hardship but also a waste of human resource potential, with a high economic and societal cost. Given the challenges posed by demographic change and the declining supply of labour, the integration of disadvantaged groups in the labour market is vital for the economic development and social cohesion of both the EU as a whole and individual Member States.

Increasing the employment prospects of disadvantaged groups requires a holistic approach consisting of a comprehensive mix of policy measures aimed at both the labour supply and demand side. On the labour supply side, it is essential to focus on skills development through tailored education and training; implement effective labour market policies including increased individual responsibility for actively seeking work; and reform tax and benefit systems in order to remove disincentives to work.

On the labour demand side, it is important to reduce non-wage labour costs, especially for those in low-paid work, in order to keep and create jobs and improve the employment prospects of disadvantaged groups. In addition, weaker groups would also benefit from more flexible labour legislation.

The development of pathways to better work is also necessary to guard against the possibility of people being trapped indefinitely in low-skill jobs.

### **To conclude**

Boosting productivity and employment growth is essential to ensure Europe's social and economic success. This must be a central concern for policy-makers and social partners alike. In order to correct structural weaknesses on European labour markets, firm and forward-looking action is needed to increase flexibility, contain labour costs, design effective tax and benefit systems and ensure a better match of labour market supply and demand.

The responsibility for action to achieve these goals lies primarily with the Member States and most of the decisions will have to be taken at national level. However, Europe also has an important role to play. The emphasis at EU level should be on

- stronger surveillance of reforms undertaken by the Member States,
- ensuring overall consistency of EU policies under the European growth and jobs strategy and a more effective system of economic governance.

European Social Partners can play a useful role if they are able to:

- agree on a joint description of the key labour market challenges and the key ingredients of the policy mix necessary to improve Europe's overall growth and jobs performances;
- make sure that the joint initiatives taken as part of the EU social dialogue work programme 2006-2008 are consistent with their joint analysis and contribute to necessary labour market reforms.

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<sup>2</sup> Commission communication on action at EU level to promote the active inclusion of the people furthest from the labour market