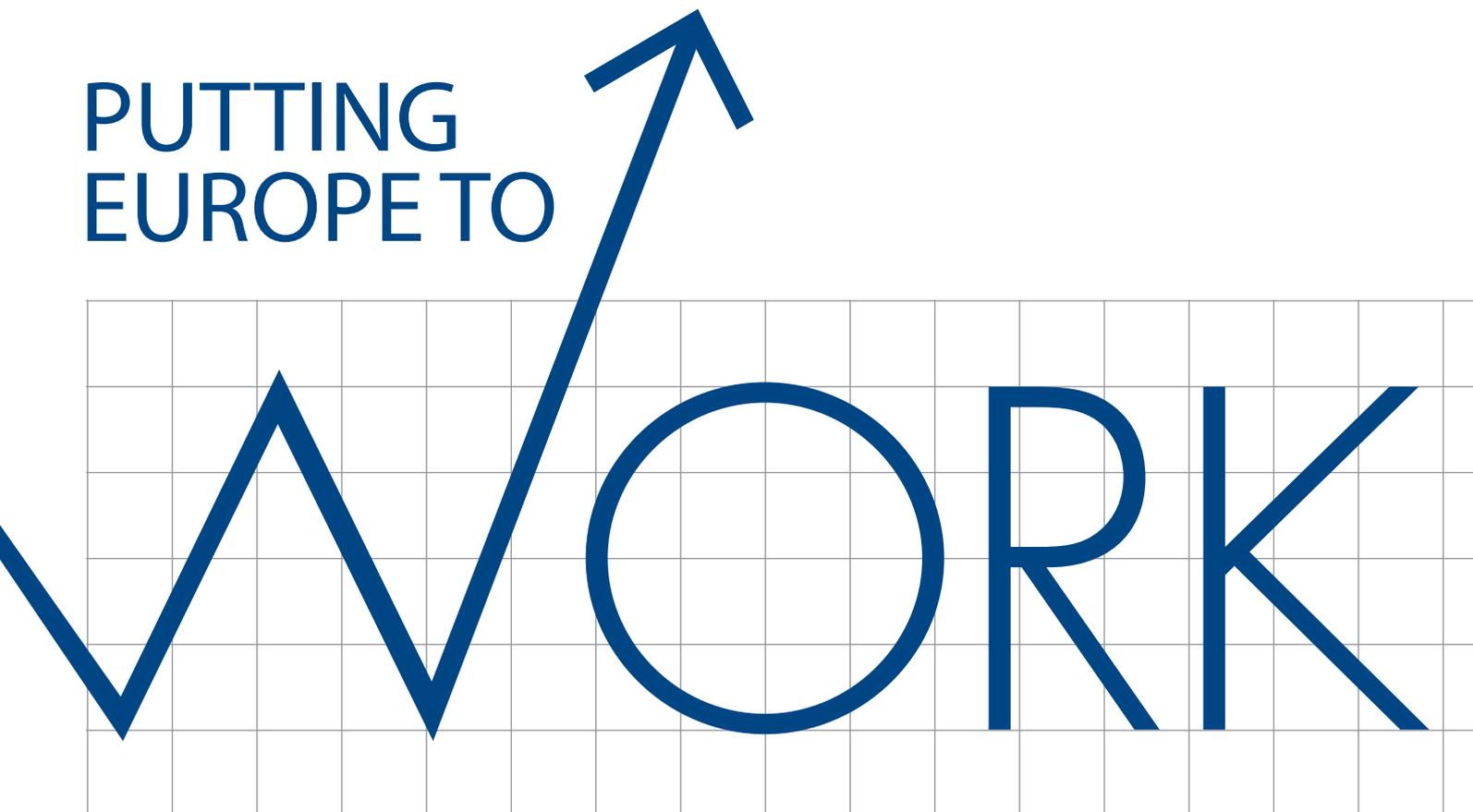




PUTTING
EUROPE TO



THE CASE FOR LABOUR MARKET REFORMS

FOREWORD

- In the wake of the economic and financial crisis, it is clear that the difficulties European labour markets are struggling with are not temporary ones. They reflect underlying structural weaknesses. This is demonstrated not least by Europe's failure to deal with chronically high long-term unemployment.
- To improve the health of the patient, a proper diagnosis must first be set. In this paper, BUSINESSEUROPE aims to set such a diagnosis of the functioning of European labour markets, by analysing their weaknesses in depth.
- The need for reform measures to address them is pressing. International competition is getting tougher; the BRIC countries have emerged stronger and more quickly from the financial and economic crisis, spurred on also by a dynamic, motivated and increasingly skilled workforce. By contrast, Europe's population is ageing, its workforce shrinking and the sustainability of its pension systems at risk.

› IN OTHER WORDS, THIS IS THE MOMENT OF TRUTH FOR MEMBER STATES TO COMMIT TO REFORM.

- And the right framework to do that is the flexicurity approach. In a post-crisis environment characterised by austerity, boosting the private sector's capacity to create jobs will be more important than ever. Implementing flexicurity policies is absolutely essential in this respect; to ensure the right conditions for growth and employment in the long run.
- Based on the analysis of the state-of-play of European labour markets, the paper presents concrete reform measures. With the check-list for action on the next page, we will monitor whether member states will follow suit on the first steps towards reform taken through the Europe 2020 strategy and the Euro Plus Pact.



Jürgen R. Thumann
President
BUSINESSEUROPE



KEY ACTIONS

- › Allow for different forms of contractual arrangements to meet current and future business needs
- › Upgrade and update skills to meet demands of the labour market
- › Make permanent contracts employment-friendly to stimulate hiring
- › Develop tools to validate non-formal and informal learning
- › Improve possibilities for internal flexibility
- › Improve quality and relevance of educational courses, including the quality of teachers' education
- › Improve wage bargaining and wage-setting systems
- › Include employability as one dimension of university rankings
- › Shift towards more active labour policies in parallel with reforms of social security systems
- › Cut red tape to encourage companies to provide apprenticeships
- › Open up for private agencies to provide employment services
- › Join forces to increase the attractiveness of vocational education and training

DIAGNOSING EUROPEAN LABOUR MARKETS

1 GROWTH AND LABOUR MARKET INDICATORS

1.1 Economic growth is lagging behind

The economic recovery in Europe has been stronger than expected and real GDP growth forecasts have been adjusted upwards for 2011, to around 2%. However, divergences between member states are substantial, reflecting previous imbalances within the EU. The recovery has been particularly strong in Germany, Sweden, Poland and Finland. By contrast, growth in Greece, Romania, Latvia, Spain and Ireland was negative in 2010.

Moreover, Europe is lagging behind its major competitors, both in terms of recent economic growth and seen over a longer time span. When comparing the third quarter of 2010 with third quarter of 2009, GDP grew by 2% in the EU whereas GDP grew by 3.2% in the USA.

Looking back over the past 15 years, the pattern is the same:

- Over this period, growth in real GDP reached around 31% in EU27.
- In the USA, Canada, South Korea and Australia the corresponding figures are 46%, 47%, 93% and 65% respectively.

1.2 Low labour market participation

A Low employment rates

In the wake of the economic and financial crisis, the employment rate in EU27 stood at 64.2% in 2010. Since the third quarter of 2008, employment has decreased in Europe, with the most severe contraction taking place in the first three quarters of 2009. Leaving the effects of the crisis aside, low employment levels are a long-standing feature in Europe. Over the last decade, employment in the EU has lagged behind the USA and Japan by several percentage points. The same goes for European activity rates.

Older workers (55-64 years) in particular have a low employment rate, at 46% in 2010. For this group, looking at activity rates complementary to employment rates is illuminating to find out to what extent they are available to work in the first place:

- Although the activity rate has increased by over 10% since 1995, it stood at only 49.2% in 2008.
- At the same time, the average real exit age has increased only slightly since 2001 to reach a level of 61.4 years in 2008.

B High (long-term) unemployment rates

In March 2011, the unemployment rate in EU27 stood at 9.5%. This corresponds to 22.828 million men and women without jobs. In comparison with the USA, the unemployment rate is now similar. Over a longer time span however, unemployment rates in the EU have been significantly higher than in the US, as illustrated by **Chart 1**.

It is clear that certain groups have been hit harder than others, in particular youth. Unemployment for 15-25 year olds in some countries reached near or even above 40% during the recession.

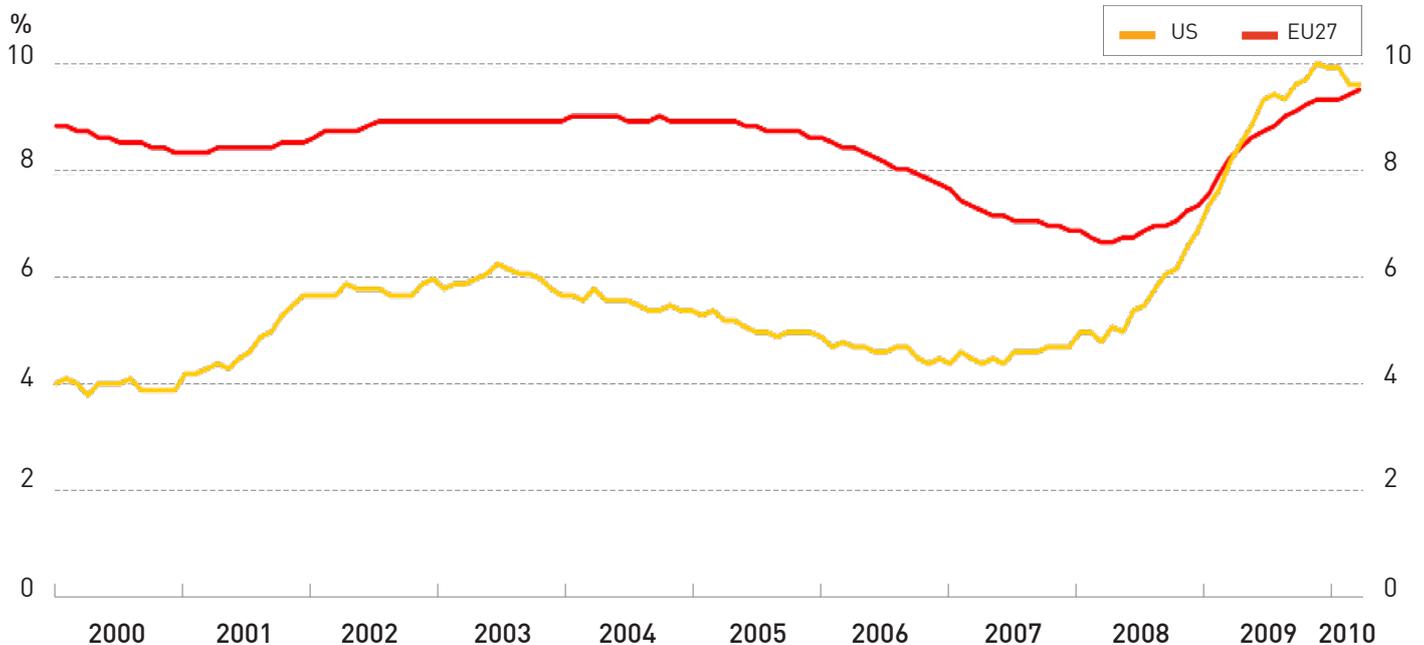
The post-crisis situation for this age group has remained constant at high levels and forecasts do not point to significant improvements in the next year. For instance, above 40% levels for young people in Spain are predicted according to the OECD.

Historically speaking, the EU has struggled with long-term unemployment. Also, compared with the US, unemployment spells in the EU are longer.

The share of people in long-term unemployment out of all unemployed in EU27 reached 19.4% in the third quarter of 2010. Moreover, this share is increasing across all age groups in Europe.

Chart 1 Unemployment rate over the past decade in the EU and in the USA

Source: US Bureau of Labor Statistics, Eurostat, Monthly unemployment statistics



The development in absolute numbers since the first quarter of 2008 is outlined in **Chart 2**. Not only are the pillars growing higher overall, the segments representing the longest unemployment spells of 6-11 months, 12-17 months, 18-23 months have expanded remarkably since 2008, according to the European Commission's 2010 Employment in Europe Report.

The recent crisis naturally led to people in short-term unemployment increasing as well. Europe now faces a real threat that also the massive inflow of people to unemployment during the recent crisis will become long-term unemployed.

1.3 Alarmingly low labour productivity growth

It is clear that labour productivity growth has been slowing down dramatically for quite a while in the EU:

- It dropped from 2.6% annually over the period 1970-1995 to 1.6% annually in 1995-2000 and then slowed down further after 2000.

- Over the period 2000-2009, average labour productivity growth for all sectors was 7.9% according to Eurostat, i.e. around 0.8% a year on average, which is very low.

There is a wide variation between EU member states, with Central and Eastern European countries experiencing a rapid acceleration of labour productivity growth since 1995, while the EU15 countries by and large experienced a slowdown. In Finland, Sweden and the UK however, the growth has been relatively fast.

Chart 2 Unemployment rate by duration for the EU, 2008Q2-2010Q2

Source: Eurostat, EU Labour Force Survey, DG Employment calculations

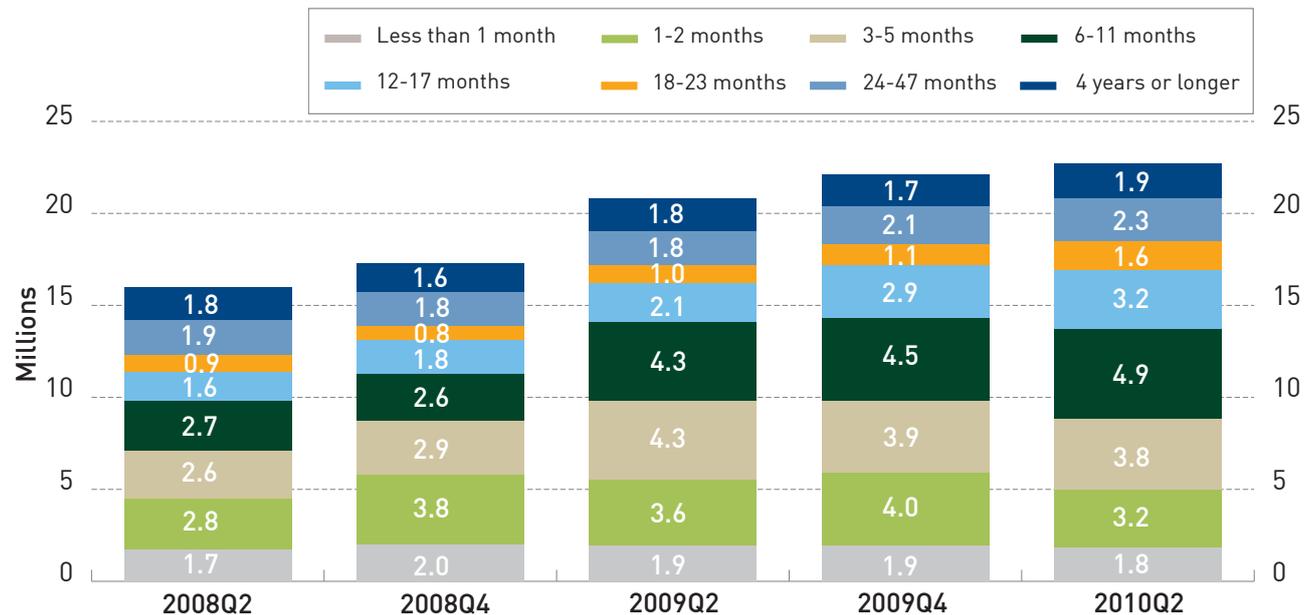
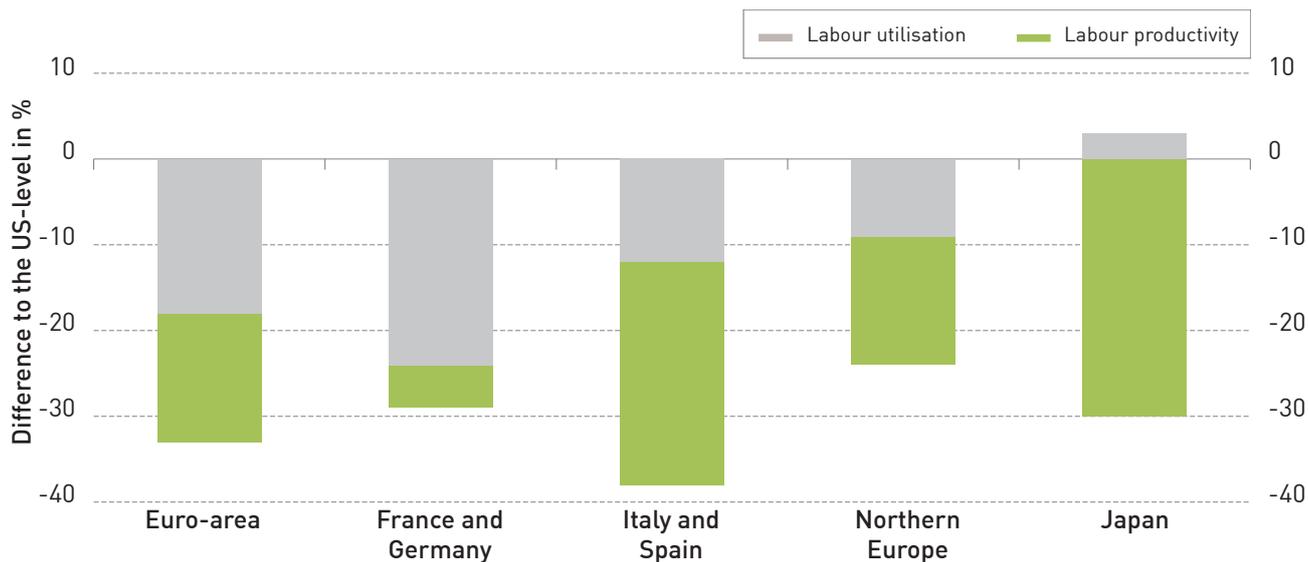


Chart 3 Labour productivity levels and labour utilisation levels in the EU and Japan compared to the US

Source: Mourre (2009), European Commission, and International Monetary Fund's staff calculations



The labour productivity growth in Europe stands in striking contrast to that of the US, where labour productivity growth accelerated considerably since mid 90s to 2005. **Chart 3** shows the difference in terms of labour productivity and labour utilisation between different parts of the EU on the one hand and the US on the other in 2006-2008. It reveals for instance that labour productivity in Italy and Spain was more than 20% lower than in the USA in this period.

Looking ahead, a consequence of demographic ageing is that productivity will have to increase dramatically to compensate for the shrinking of the work force:

- The per capita economic growth rate for EU25 is expected to decline from 2.1% in around 2020 to 1.5% in 2050.

This means a continued lower level of output growth in EU15 than in US. However, this exceeds the level projected for Japan, which can be explained by the fact that Japan faces even more pronounced effects of ageing.

In line with the low labour productivity growth in Europe, the unit labour cost (ULC) has simultaneously increased in Europe.

Stronger growth in labour productivity than in average labour compensation will have a downward impact on growth in unit labour costs and vice-versa. Between 2000 and 2009, ULC rose by 13.1%.

2 STRUCTURAL LABOUR MARKET FACTORS

Efficient labour markets are about smooth transitions, including between jobs, from unemployment to employment and between the worlds of education and work. It is about achieving a good match of skills supply and demand. It is also about incentives for companies to hire, creating employment in the first place. Unfortunately, as this section will show, this is not yet the reality today in most European countries which are characterised by high levels of labour market rigidity and low levels of mobility as well as important skills mismatches.

2.1 Inefficient European labour markets

Let us take a look at how our labour markets are functioning. Three main inefficiencies emerge that all stand in sharp contrast to the efficient, flexible labour markets we should be aiming for:

A EU labour markets are too rigid
According to the ranking of employment rigidity defined as difficulty of hiring, rigidity of hours, and difficulty of firing included in the 2009-2010 annual Global Competitiveness Report by The World Economic Forum, fourteen of the EU27 countries ended up in the last third of the 136 countries covered in the report, meaning that they have among the highest levels of employment rigidity:

| | |
|---|---|
|  Luxembourg (127th), |  Portugal and  Latvia (110th), |
|  France (124th), |  Germany and  the Netherlands (108th), |
|  Estonia (123rd), |  Finland (104th), |
|  Greece (121th), |  Italy,  Lithuania and  Sweden (90th). |
|  Spain (119th), | |
|  Romania (114th), | |

By contrast, the USA, Canada, Australia and New Zealand are all among the countries with the least employment rigidity.

There are exceptions though, and these deserve attention. Denmark and UK perform better in the ranking mentioned. These countries are known for their relatively liberal labour markets.

Rigid labour markets also have a negative impact on voluntary job movements by making it more difficult for workers to move to a job or better employment opportunities. This helps to explain the relatively low level of occupational mobility in the Eurozone compared with the OECD average measured as the percentage of employed people with less than a year of employment in the same job.

B Skills supply and demand do not add up
Co-existing with the unemployment levels described above, the job vacancy rate in EU27 grew from around 1.5% in 2003 to above 2.2% in 2007. Even during the crisis, vacancy rates were high.

- At the end of 2009, there were still 450,000 vacancies in the UK and 118,000 in the Netherlands, to name just two countries.
- The difficulties employers experience in filling vacancies vary widely between sectors and even within sectors.
- The number of unfilled positions in the ICT sector is currently around 300,000, with 10,100 ICT skilled employees lacking in Italy, 18,300 in Poland, 41,800 in Spain and 87,800 in Germany.
- The European Commission estimates that by 2015 shortages of ICT workers will be between 384,000 and 700,000 jobs.

Overall, the current and projected shortages within science, technology, engineering and mathematics are particularly important. During the crisis, the lack of employees with such skills was only moderately eased. The latest figures show that the shortage is again increasing.

Geographical mobility in the EU not exploited enough

According to the latest Eurobarometer survey, 53% of young people in Europe are willing or keen to work in another European country. At the same time, the actual level of such mobility within the EU is still very low. Currently, around 2.4% of all European nationals live or work in another Member State. Among young people, one in seven has been abroad for education or training.

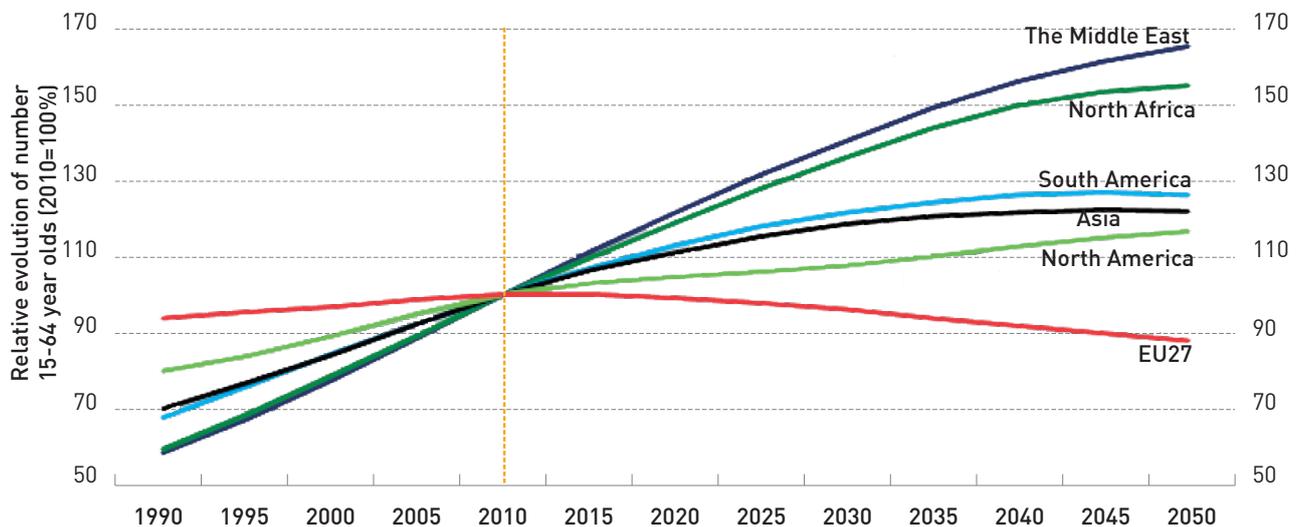
Geographical mobility in the EU is hampered partly by obstacles linked to the functioning of our labour markets, but also other types of obstacles for instance the different languages spoken. Nevertheless, the low mobility rate points to significant room for improvement.

2.2 Ageing of the work force

Europe's work force will start shrinking in the next few years. This is due to the dramatic change in age structure. In a zero migration scenario, the EU's working age population will decline by 10% in 2030 and by 20% in 2060. Even when taking immigration flows into account, the development in working age population in relative terms in the EU follows a different trajectory than other economies, as illustrated in **Chart 4**. The chart shows the relative evolution of number of 15-64 year olds with 2010 as baseline. This means among other things that the average old-age dependency ratio will double by 2050, i.e. the proportion of people aged over 65 to those aged 15-64 years. Outside the EU, working age populations will grow during the same time span.

Chart 4 Relative development of working age population for EU27 and other parts of the world

Source: Europop2008, Eurostat



3 THE SKILLS CHALLENGE

A Millions of jobs will be created

Turning to the demand side of the labour market, EU businesses will create 1 million jobs in 2011, according to the projections made by BUSINESSEUROPE in its economic outlook 2011.

Looking even further ahead, the projections of Cedefop – the European Agency for vocational education and training - show that the replacement demand due to retirements for all job categories will result in 73 million job openings over the period 2010-2020. This demand will be particularly important in certain occupational fields, such as physics, mathematics, engineering, health, life science and teaching professionals, when measured in absolute terms. Around 7 million new jobs will also be created, resulting in a demand for technicians and associated professions in particular. Counting both replacements and the new jobs that are estimated to be created, the net employment effect by 2020 is a total of 80 million additional job openings.

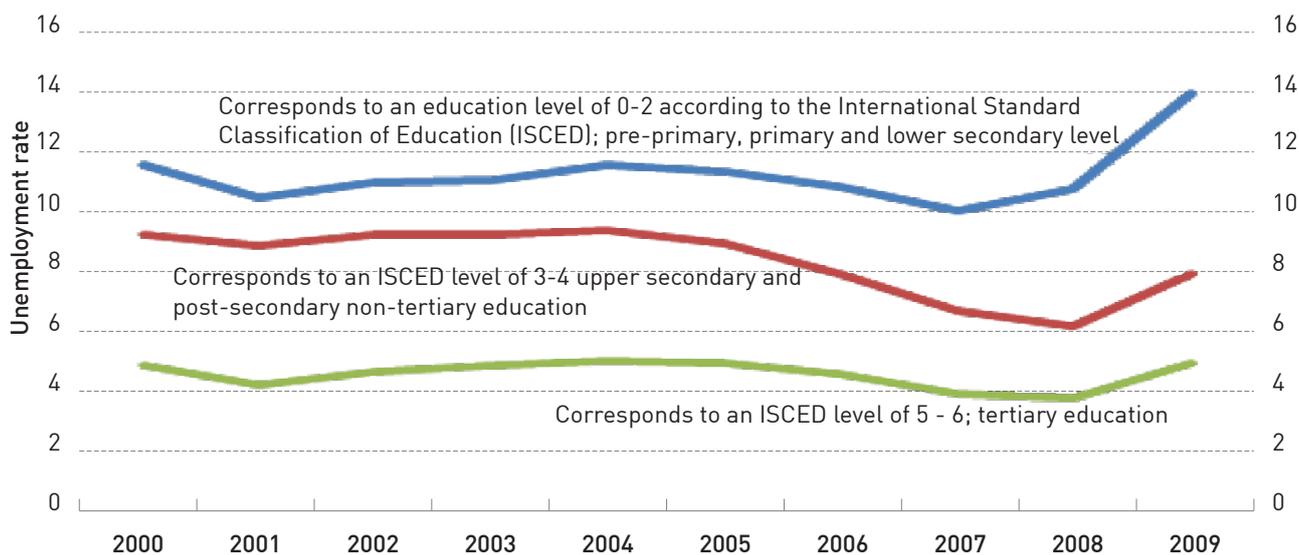
B Jobs that demand higher skills

In the next decade, the trend towards a growing demand for highly skilled individuals will continue. The need for highly skilled workers is projected to rise by 16 million by 2020 and the corresponding figure for medium-skilled workers is 3.5 million. At the same time, the demand for low-skilled people will decline by 12 million.

However, more elementary jobs within services are expected to occur as a consequence of the structural shift towards a larger share of the work force in high-skilled jobs with higher remuneration, as the improved living standard will lead to more consumption of services.

Chart 5 Unemployment rate by highest level of education attained in EU 27

Source: EUROSTAT



Although the supply of those with medium-level qualifications is expected to increase to a lesser extent than the highly qualified, they will still form 50% of the labour force. In particular technical vocational skills will be in high demand in the coming years. As is shown in **Chart 5**, a high skills level already makes a significant difference in prospects for finding employment:

- Unemployment rates for people who have attained only a pre-primary, primary or lower secondary education level were between 10 and 12% in 2000-2008 and rose sharply in 2009 to 14%.
- By contrast, unemployment levels among those with upper secondary and post secondary (non-tertiary) education decreased during the same period to slightly above 6% in 2008.
- Following the same pattern, unemployment rates over the period 2000-2009 for people who have attained a tertiary education level are between 4 and 5%.

Although higher education increases chances on the labour market, it should be noted that Europe's students are taking longer and longer to complete their studies and enter employment. The minimum age of the oldest students in tertiary education has increased for almost all members of EU27 since 1998.

The 2010 PISA survey carried out by OECD showed mediocre performances of 15-year-olds in the EU in science, reading and mathematics compared with South-East Asian economies, like South Korea and Japan. Moreover, the USA performed better than the vast majority of EU member states. In the EU, Finland stands out as an exception joining the South-East Asian economies at the top of the ranking.



STRUCTURAL REFORMS FOR GROWTH AND JOBS

“Accelerating structural reforms in the years ahead would not only improve longer-term growth prospects, but also help to reduce the likelihood of similar financial crises and enhance resilience to adverse economic shocks (OECD, 2008)”

The figures on employment levels and the hard facts on rigidities in European labour markets presented in the previous chapter speak for themselves. It is clear that something needs to be done if the EU is to have a realistic shot at attaining the 75% employment rate target as set out in the Europe 2020 strategy. Increasing the flexibility on our labour markets is indispensable to stimulate companies to hire. In addition to this, reform measures including shifting to cost-efficient active labour market policies, providing opportunities for lifelong learning and putting in place modern welfare benefit systems are needed to improve the functioning of our labour markets.

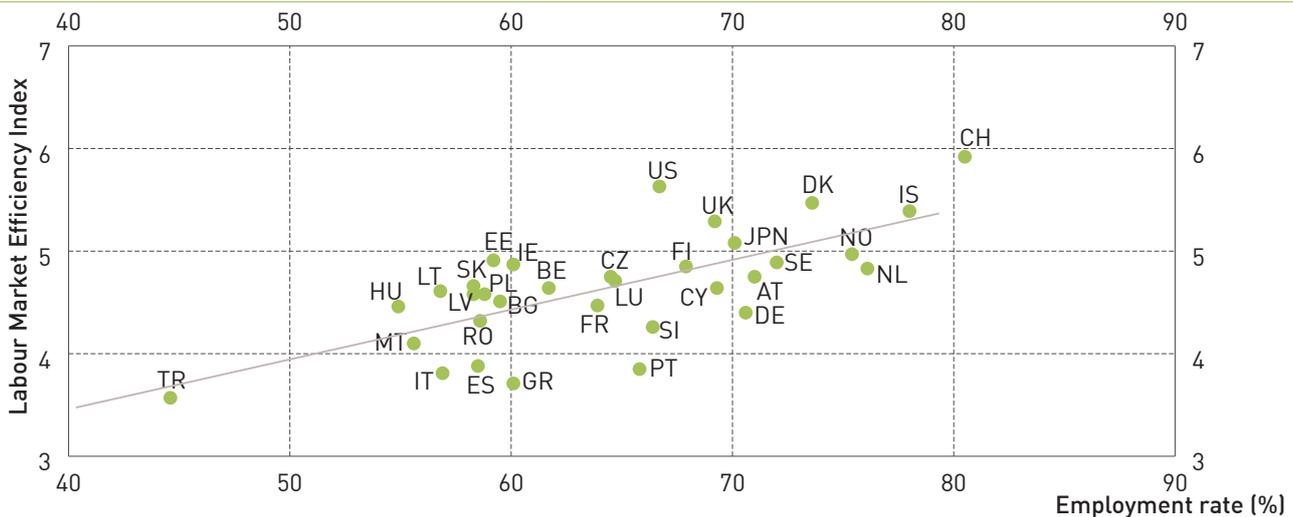
The flexicurity approach is the right way forward for undertaking these necessary reforms. In the joint labour market analysis from 2007, and in their joint statement on the Europe 2020 strategy, European social partners state their support for the flexicurity approach. In the following sections, the importance of implementing the principles of this approach urgently in order to meet the 75% employment rate target will be described, along with the reforms in labour taxation required to this end.

1 LABOUR MARKET FLEXIBILITY

As is illustrated in **Chart 6**, there is a positive correlation between the labour market efficiency index and employment rate.

Chart 6 Correlation between labour market efficiency index and employment rate in EU 27

Source: EUROSTAT



This index is composed to 50% of indicators on efficient use of talent, and to 50% of indicators on flexible labour markets, including flexibility of wage determination, hiring and firing practices, extent and effect of taxation, etc.

As a response to the crisis and falling order levels for companies, several countries improved internal flexibility through working time accounts and part-time possibilities as a way to avert mass redundancies.

One of those countries was Belgium, which with its “anti-crisis” act of 19 June 2009 enabled employers to reduce working hours and thus reduce wage costs. Belgium is also one of the few member states that have already seen employment recover to the levels of mid-2008. According to the European Commission Joint Employment Report of 2010, this is largely due to the widespread use of internal flexibility on the Belgian labour market and a high elasticity of employment relative to the fall in economic activity.

Maybe the most remarkable example of the benefits of allowing for more internal flexibility is the case of Germany and its short-term work arrangements and previous Hartz reforms. This is outlined in more detail in **Box 1**. In view of the structural weaknesses of European labour markets demonstrated in the previous chapter, enabling working time accounts must not be seen as a temporary infusion to increase the adjustment capacity of labour markets reserved for crisis situations. In the recovery and beyond, a smooth adaptation to changes in order levels for companies will remain vital.

➔ **Improve possibilities for internal flexibility.**

BOX 1 IMPROVED FLEXIBILITY BEHIND GERMANY'S JOB PERFORMANCE



In Germany, the labour market reforms that came into effect between 2003 and 2005 enlarged firms' internal flexibility by general agreements on the company level and by opening clauses within collective bargaining agreements, mainly concerning variations in working time and wages. In addition, a growing number of firms introduced working-time accounts whose aim was allowing working hours to adjust to changes in demand more swiftly. Moreover, these reforms marked a cornerstone in enhancing external flexibility on the labour market. Key components of these reforms were facilitations in temporary employment, easier management of marginal employment (the so called “Mini-Jobs”) or reorganisation of the federal employment agency.

Already during the crisis, Germans harvested the benefits of having increased the flexibility of their labour market in previous years. Scientific studies carried out by the Institut für Arbeitsmarkt- und Berufsforschung (IAB) show that around 1.2 million jobs were saved in the year 2009 alone using flexible working time agreements and short-time work allowances. In spite of its GDP taking one of the hardest hits across Europe, Germany's unemployment only rose by 160,000 in 2009. In fact, current levels of joblessness of around 3 million have not been as low since 1992. Without internal and external flexibility on the labour market, the country would not have weathered the crisis so successfully.



Equally important as internal flexibility has proved to be for improving the functioning of our labour markets is external flexibility.

➔ **Allowing for different forms of contractual arrangements including temporary contracts is necessary to meet current and future business needs.**

External flexibility does not come at the expense of permanent employment, contrary to what is often feared. For example, 80% of jobs created by agency work would not have existed if agency work were not an option according to Eurociett, showing that external flexibility leads to job creation and not job substitution. Figures from OECD also show that part-time jobs do not come at the expense of full-time employment.

In fact, studies from OECD and other sources show that temporary employment in most cases functions as stepping stones to permanent employment for young job starters.

Moreover, temporary jobs functions as a mode of entry into the labour market for people in unemployment, as illustrated by the fact that exit rates from unemployment into temporary contracts are much higher compared with exit rates into permanent ones.

This is to be expected since temporary contracts offer an efficient and secure way for employers to recruit young people and first-time entrants to test their skills and qualifications.

Further to the need to provide for a range of contractual options for employers, it is crucial to ensure that employment protection, in particular for permanent contracts, corresponds to the needs of the labour markets.

➔ **Permanent contracts should be made employment-friendly to stimulate hiring with provisions that give legal certainty and predictability for the establishment and termination of work contracts.**

BOX 2 MORE FLEXIBLE CONTRACTUAL ARRANGEMENTS RAISED EMPLOYMENT RATES IN ITALY



Spurred by the Treu and Biagi reforms of the late 1990s and early 2000s, strong employment growth took place in Italy in the ten years before the recession, halving the unemployment rate from 11.8% in 1997 to 6.1% in 2007. In the same period the employment rate increased from 51.3% to 58.7% and the activity rate from 58.2% to 62.5%.

These reforms strongly helped to boost employment, by providing greater flexibility in the work organisation, through a variety of flexible contractual arrangements.

In particular, the new flexible contracts fostered employment of women and young people who have greater difficulties in entering the labour market. Specifically, from 1997 to 2007 the female employment rate in Italy increased from 36.4% to 46.6% whilst in the same time frame the female unemployment rate strongly decreased (from 15.1% to 7.9%).

As regards youth unemployment, though still high, in a decade it decreased by one third, going from 30.2% to 20.3%.

It is therefore alarming that little has happened in terms of reform activity in the field of employment protection legislation in recent years. Countries where such legislation is characterised by very strict rules, for instance Spain, the reforms are only tentative. Some flexibility has been introduced for new entrants to the labour market, whereas protection legislation for permanent contracts has remained unchanged.

In this context, the Commission's concerns about increasing labour market segmentation should be mentioned, as a continued over-protection of permanent contracts risks adding to such a development. This will be developed more in detail in the section on youth.

Greater wage flexibility is also vital to support job creation and competitiveness, better reflecting labour market and productivity conditions and limiting wage and price inertia.

➔ Improving wage bargaining and wage-setting systems came as one of the urgent priorities identified by BUSINESSEUROPE's member federations in the 2011 Reform Barometer.

From the perspective of the worker, increased flexibility accompanied by well-functioning social security systems, efficient active labour market policies, education and training systems etc. will make transitions from one job to another smoother. By creating employment security rather than security in a particular job, a modern flexicurity approach stimulates mobility on the labour market. This in turn strengthens the career opportunities of the individual worker by enabling both voluntary job transitions and the ability to find a new job if made redundant.

2 THE RIGHT INCENTIVES ON THE LABOUR MARKET

A Shifting towards active labour market policies

B Reforming welfare benefit systems

C Reducing the tax burden on labour

D Investing in lifelong learning

As a response to the critical situation concerning the low labour market participation depicted in the section on the structural landscape of Europe, one would expect that a series of reforms would have been undertaken to boost this level. However, this is only partly the case.

Labour market reforms are still needed, particularly in the following four policy areas:

A Shifting towards active labour market policies

The mismatch on European labour markets is not a temporary issue. It is a long-standing feature, illustrated by the coexistence of high unemployment rates with an increasing number of unfilled vacancies. It is reflected in companies' acute demand for labour with certain skills in particular within science, technology, engineering and mathematics. And it is felt by the millions of Europeans stuck in long-term unemployment, yet another trademark of EU labour markets.

This situation is not tenable for companies, nor for workers. The path to come to terms with the mismatches passes through active labour market policies.



Over the past decade, a progressive shift has taken place in several member states from passive policy actions to active labour market policies, with an emphasis being put the matching process between labour supply and demand. Efforts to improve the capacity to provide effective job search have been made, flanked by a boosting of early stage activation measures like training. The most widespread action to this end was the restructuring of public employment agencies, involving a rationalisation and modernisation of their services.

These efforts have already paid off in countries that have redirected resources from passive measures to active. A key element in the successful shifts has also been ensuring cost-effectiveness. In view of the constraints on public finances, investing resources in cost-efficient measures that have proven successful is vital both on the national level and EU funds like the European Social Fund.

In concrete terms, the reforms has meant agencies taking a more active role as providers of counselling, job-search and placement assistance services rather than merely distributing unemployment benefits. This in turn has lead to more targeted and individualised activation measures.

Ultimately, the effect of such changes in employment services is a higher level of employment. The literature is increasingly showing positive results from shifting towards active labour market policies (OECD, the European Commission, CESIfo). This is what lies behind the improved performance of several European labour markets over the last decade and a half, up until the crisis.

By contrast, it is further shown that passive measures like subsidised public sector employment programmes have the least favourable impact.

During the crisis, and in particular in the post-crisis era with cuts in the public sector, public employment services in many countries lacked the capacity to keep up or put in place such targeted measures.

By contrast, private employment agencies are often specialised in matching unemployed with a specific skills profile with jobs in a certain field, or providing training that quickly enables a worker made redundant to pick up a job in another sector.

 **To ensure efficiency in the delivery of employment services, it is vital that possibilities for private actors in this field are opened up.**

Not only does it bring much needed competition to public sector providers, it also enables the different needs of a broad and divergent group of job seekers to be better met.

Further to letting private employment agencies into the field in the first place, cooperation between private and public employment agencies should be strongly promoted in order to make the most of scarce resources.

B Reforming welfare benefit systems

In a situation with a high level of unemployment benefits, the reservation wage, that is the lowest wage level at which an unemployed person is prepared to give up unemployment benefits in favour of a salary, will be high. This is especially the case if taxes on labour are high as well, since the difference in compensation is mostly “taxed away” due to higher tax and social security contributions. As an example, Eurostat figures show that for a one-person, low-wage household, 75% of the extra income when an unemployed person finds a job is “taxed away” through higher tax and social security contributions combined with the withdrawal of unemployment and other benefits.

For the individual, this leads to an unemployment trap. In other words, his or her incentives to enter the labour market diminish the longer compensation levels are kept up.

➔ **The shift towards more active labour policies should be carried out in parallel with reforms of social security systems, thus strengthening the incentives for the beneficiary to look for a job.**

This has been targeted in some member states. In Denmark for instance, the gradual intensification of activation measures has been accompanied by financial incentives for welfare recipients to find employment. A cap on social security has been introduced, which sets an upper limit on how much an individual can receive in total benefits. The cap kicks in after 6 months.

It is further crucial to introduce tighter eligibility conditions linked to participation in activation measures and compliance with job search requirements as a sort of “mutual obligations” approach. This is especially important in countries with a longer duration of unemployment benefits.

The effects of these reforms have been a reduced scope of the unemployed to turn down job offers on the basis of workplace location, incompatibility with previous job profiles, etc. Such measures are very promising as instruments to reduce disincentive effects see UK example in **Box 3**.

Social protection systems need to be further modernised to increase their efficiency and ensure that they are cost-effective.

This is particularly important in view of increased pressure on public finances, particularly due to an ageing population.

There is likely to be a greater use of public services, for example healthcare and social services, in the future due to changes in the age structure of the population.

Social protection systems should not only be geared towards income support, but also towards motivating individuals to return to the labour market. Higher levels of employment are also needed to avoid financing gaps in social protection systems.

BOX 3 BENEFITS REFORM IN THE UK: THE UNIVERSAL CREDIT



The UK government plans to introduce a “Universal Credit” to replace most in-work and out-of-work benefits for people of working age. The intention is to introduce the Universal Credit for new claims from October 2013, with the aim of completing the transfer of all existing claimants to the new system by October 2017.

A key feature of Universal Credit is a single “taper” for the withdrawal of the Credit for those in work. As earnings rise, Universal Credit is to be withdrawn at a constant rate of 65 pence for each pound of net earnings.

The financial support provided by Universal Credit is underpinned by a new “conditionality” framework setting out the responsibilities claimants may be required to meet. The level of requirements will depend on the claimant’s circumstances. The conditionality framework is backed up by a new sanctions regime for non-compliance which provides for a reduction in Universal Credit payments for periods of up to three years.



Reforms are needed in European pension systems in particular. One such recent example is Spain where the government and the social partners agreed on reforms that will reinforce the sustainability of the pension system and foresee incentives and mechanisms to promote later retirement.

With a decreasing number of people on the labour market and the growing number in retirement, the sustainability of our pension systems is at stake. Therefore there need to be more people at work and working longer. This is the most effective way to pay for pension expenditures. Raising the statutory retirement age is important in this context, as a number of member states have done recently.

In several countries, a simplification of existing schemes for reductions of such contributions was enacted in the past decade.

Cuts in labour taxation obviously come with an immediate cost that could be difficult to handle for many governments currently, considering the constraints on public finances. However, it should be noted that viewed over a longer time span, the costs are covered due to the positive effect they would have on employment. Estimates from OECD show that a 1% decrease in the employer's social security contribution leads to a 0.6% increase in employment. Currently, a reform on labour taxation is being implemented in Sweden. The experiences so far from the reform steps implemented are outlined in **Box 4**.

C Reducing the tax burden on labour

In order to stimulate both the supply and demand side of labour, the tax burden on labour should be reduced. It is particularly important to make work a more economically attractive option for low-income earners compared with welfare beneficiaries. It is equally important to stimulate the demand side, for instance through targeted cuts in employers' social security contributions.

BOX 4 TAX REDUCTIONS ON LABOUR BOOST WORKING HOURS IN SWEDEN



In Sweden, a tax reduction on labour taxation and business operations has been introduced in different steps, the first one coming into force in 2007. The effect of the reduction in relative terms is largest for low-income earners, in line with the aim of increasing incentives for those that stand on the side of the labour market to look for jobs. The Swedish Centre for Business and Policy Studies estimates that the net effect of the reform is an increase in the number of working hours by 2%.

In spite of the fact that the tax reductions all in all will diminish the Swedish public treasury by over 6.5 billion Swedish krona, the reform is still projected to be self-financing since the impact it will have on employment will lead to higher tax revenues for the state. This will compensate for the initial tax losses. The reform was recently highlighted as a best practice at the Economic Forum in Davos.

D Investing in lifelong learning

In view of the projections of future skill demands described in the section “Structural Landscape”, there is no doubt that Europe is facing a major skills challenge. In addition to the difficulties companies are already reporting when it comes to recruiting skilled individuals, the low productivity growth of Europe in the past decade also points to the urgency of improving skills in the work force at all levels.

Since effects of reforms to the education and training system do not become visible over night, it is high time for stakeholders to act, in order to avoid the dramatic effects on economic growth projected for the next decades. Employers are fully committed to providing their employees with lifelong learning opportunities. Recent data from Eurofound, the EU agency for analysing living and working conditions, shows that training paid for by employers was at its highest level since 1995 for EU15. Moreover, on-the-job training has also increased over this period. In the UK alone, businesses invested £39 billion in skills training only in 2008.

The reforms called for in previous sections with a view to increase flexibility on European labour markets, to improve the functioning of our social benefit systems or to reorient resources to active measures on the labour market should not be seen in isolation from investments in lifelong learning.

By contrast, they should all be flanked by measures that develop workers skills and competencies.

➔ **Upgrading and updating of skills are vital components in the overall policy package.**

To this end, it is important to ensure that the doors to education and training providers remain open throughout an entire career.

➔ **By developing tools to validate non-formal and informal learning, for instance the kind that takes place at a work place, access to lifelong learning for workers would increase.**

One example of a reform building upon improved lifelong learning possibilities with a view to increasing employment is the 50+ programme launched in Poland. This reform is described more in more detail in **Box 5**.

Further to opening up possibilities for learning and re-training throughout an entire career, a modernisation of initial education is crucial as well. This will be described further in the section on youth.

BOX 5 LIFELONG LEARNING HELPS POLAND COPE WITH DEMOGRAPHIC CHALLENGE

As part of the measures intended to keep older workers in employment longer, the Polish government launched the 50+ programme in 2008. The programme provides workers of age 50 and above with lifelong learning opportunities in order to develop the qualifications, skills and efficiency of this age group. This follows from the ambition to reduce labour costs in case of declining productivity. The goal is to increase the employment rate for people aged 55-64 years from the current 28% up to 40% in 2013.



THE YOUTH PARADOX

Young people of today are more educated than ever. A larger share continues into tertiary education than in previous decades. Moreover, they grew up in a digital world and, to them, internet has “always” existed. This gives them the tools and habit to access information and get in contact with people within milliseconds.

In other words, this generation should constitute a highly sought after influx of creativity and modern skills to the European labour markets.

However, the high youth unemployment in many EU member states stands in sharp contrast to the potential of the young generation. It shows that something is seriously wrong in both the functioning of our education systems and our labour markets.

Standing outside the job market is discouraging for any individual who wishes to find a job. But facing unemployment in the beginning of one’s career, perhaps after having invested years in a university education, is particularly discouraging. It is not only a serious matter of concern for the individual, but also for our economy at large. In view of demographic change and the skills shortages European companies are already struggling with, not making good use of this potential is simply not affordable. For **BUSINESSEUROPE**, the situation of Europe’s youth on our labour markets is therefore a matter of key concern.

In order to facilitate smooth transfers into employment for young people, two main actions can be singled out:

A Reduce mismatches between skills supply and demand

The structural mismatches between skills supply and demand described in the previous chapter does not only concern people with low or outdated skills. This problem originates already in an insufficient responsiveness of initial education and training to labour market needs. Moreover, European education institutions at all levels are performing poorly on an international comparison. This is particularly acute in science, technology, engineering and mathematics subjects.

➡ **It is therefore crucial to improve both quality and relevance of educational courses, including the quality of teachers’ education.**

➡ **University rankings should include employability as one of the dimensions that the universities’ performance is measured against.**

The Commission's Multirank project aiming to develop a multidimensional university ranking should be taken further and promoted at the national level. This ranking includes indicators reflecting employability of students and university-business collaborations, among a broad range of indicators taking different dimensions of the university's role into account.

Business is committed to provide their employees with opportunities for continuous training and to involve in initial education and training, as reflected in that their investment in education and training has increased in recent years.

More can be done to facilitate and encourage employers to engage in the initial education and training. The obstacles for companies to become involve are substantial, not least in terms of bureaucracy. The CBI annual skills surveys repeatedly point to the difficulties companies face when trying to navigate through the forest of agencies, rules and regulations.

➡ **In order to encourage companies to provide apprenticeships, red tape must be cut.**

The involvement of employers is not about taking over the role of teachers. It is about providing a context for the learning. Combining theoretical and practical training benefits both companies and graduates and can contribute to a smooth transition into employment for young people, for instance through work placements and internships. A work-based vocational education and training system where students alternate between being at school and working in a company should be promoted throughout Europe as a mean to reduce unemployment among young people by equipping them with skills that companies need.

However, companies should not have to substitute for the role of governments in providing good initial education. A large number of young people leave school with insufficient knowledge even of basic skills like numeracy and literacy. Their chances on the labour market remain poor, in spite of European business investing more and more in learning at the work place, partly to compensate for deficits in the national education system. Moreover, the problems of school drop-outs must be addressed urgently.

The alternative cost of failing to achieve the Europe 2020 target on reducing these to below 10% will be substantial. OECD has showed that reforms improving the average years of education of the adult population as well as measures targeting the performance of scholars are vital for an increase of GDP are among the most effective policy levers to raise GDP per capita seen on a long-term perspective.

However, apart from the reforms stemming from the Bologna and Copenhagen processes, targeting vocational and higher education systems respectively, such reforms have been notably absent so far.

➡ **Governments, education providers and business need to join forces to increase the attractiveness of vocational education and training, in particular in strategically important subjects like technology and engineering.**

B Reduce labour market rigidities and stimulate job creation

Even when a young person has the right set of skills, this does not help much if there are no jobs to apply for in the first place. In order to stimulate companies to hire overall and in particular young individuals with limited work experience, they need flexible form of employment contracts at their disposal. This not only means flexibility regarding the use of flexible permanent employment contracts but also regarding the availability of a broad range of forms of contracts. As was mentioned previously, fixed-term contracts function as a stepping stone into permanent working contracts, by allowing for gathering of experience and skills.

One country whose youth has suffered particularly hard in the recent financial and economic crisis is Spain. One of the main reasons behind this is the over-protection of individuals with permanent contracts. As a result, the use of temporary contracts has increased, even though the Spanish regulation of temporary contracts is among the most rigid ones in the OECD.

The harmful effect of unduly high employment protection legislation of permanent contracts strikes particularly hard against youth. OECD has repeatedly recommended many EU member states, most recently Sweden, France and the Czech Republic among others, to reform this legislation. Recommendations include reducing the costs of employment protection legislation for regular workers, encouraging regular employment by widening the definition of fair dismissal and lengthening the trial period of regular contract and to put in place less burdensome dismissal procedures.

CONCLUSION

Given this diagnosis of the state of play on European labour markets, there can be no doubt that reforms are urgently needed. The facts and figures on economic growth, labour productivity growth, labour market participation and the efficiency of European labour markets speak for themselves. As the report shows:

- ⇒ Growth in real GDP over the past 15 years in the USA, Canada, South Korea and Australia significantly surpasses that of the EU.
- ⇒ Long unemployment spells and low employment levels are long-standing features in Europe. The same goes for activity rates.
- ⇒ The average labour productivity growth for all sectors over the period 2000-2009 was as low as 0.8%.

Compared with other economies, Europe is no longer just facing a risk of being overtaken in terms of providing the right framework conditions for competitiveness and job creation. We already have been. This concerns for instance the quality and relevance of our education systems, the rigidities of our labour markets and the incentive structures in our welfare benefit systems.

We must not treat this alarming situation as an isolated bump in the road. The recent economic and financial crisis fully exposed underlying structural weaknesses in our labour markets. BUSINESSEUROPE's analysis shows that it is on these weaknesses that we must focus our reform efforts to get the wheels turning again.

The effects of the malfunctions are felt by European citizens and companies. Not least the 23 million men and women who together make up the 9.5% unemployment rate as of March 2011.

Or the younger generation of Europeans who are looking at forecasts of exceptionally high youth unemployment rates also for 2012.

At the same time, Europe does have a skilled work force and an innovative business community. The task will be to better match skills supply and demand and provide better framework conditions respectively.

The compilation of reform experiences in member states provided in the report presents a strong source of guidance on what could be done and what has worked in the past.

It shows that EU member states have the potential to make the necessary changes in labour markets and social systems.

To take just a few examples:

- Internal as well as external flexibility has demonstrated its value on German labour markets during the crisis, preventing lay-offs of workers from soaring.
- Tax reductions on labour have boosted working hours in Sweden.
- Shifting to active labour market policies has improved performance on several European labour markets up until the crisis.
- In Poland, lifelong learning is helping to increase employment rates for older workers.

Together, these experiences and the 12 key actions derived from them constitute a roadmap for reform, with the flexicurity principles providing the toolbox to get on with it. Building on this road map, the difficult situation in which Europe currently finds itself could be successfully turned around.



BUSINESSEUROPE



MEMBERS ARE 41 LEADING
NATIONAL BUSINESS FEDERATIONS
IN 35 EUROPEAN COUNTRIES

| | | | | | |
|--|--|---|---|---|---|
|  Austria |  Belgium |  Bulgaria |  Croatia |  Cyprus |  Czech Republic |
|  Denmark |  Denmark |  Estonia |  Finland |  France |  Germany |
|  Germany |  Greece |  Hungary |  Iceland |  Iceland |  Ireland |
|  Italy |  Latvia |  Lithuania |  Luxembourg |  Malta |  Montenegro |
|  Norway |  Poland |  Portugal |  Portugal |  Rep. of San Marino |  Romania |
|  Serbia |  Slovak Republic |  Slovenia |  Spain |  Sweden |  Switzerland |
|  Switzerland |  The Netherlands |  Turkey |  Turkey |  United Kingdom | |

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