ETUI-REHS

Full employment in the EU
From lip service to realisation

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Full employment in the EU:
From lip service to realisation

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Foreword

In 2000, the governments of the EU launched the so-called Lisbon strategy for sustainable growth and full employment. Its aim is that by 2010 the EU should be the world’s most competitive and dynamic knowledge-based economy, founded on social security and sustainable development.

Midterm evaluations in 2005 showed that the EU is far from meeting the Lisbon aims. Growth is low and there are more than 19 million unemployed in the EU. Furthermore, more than 70 million EU citizens are living below the poverty line.

At the spring summit, the EU’s heads of state and government therefore decided on a number of changes to the process which would boost the Lisbon strategy. A more coherent process was thus agreed on. It involved a higher degree of coordination between the various EU initiatives and it was also decided that national reform programmes reflecting this integrated process were to be prepared.

Both the Danish government and the social partners in Denmark have supported the adjustment of the Lisbon strategy. It is vital for the trade union organisations in Denmark and the EU to hold on to the aim of full employment and to insist that growth and increased employment go hand in hand with social progress. ‘Social security and competitiveness’ is not a contradiction in terms: the two are interdependent. This is certainly a lesson to be learned from the Danish model.

However, revision of the Lisbon process has centred almost exclusively on form and procedures, rather than on contents. In the eyes of LO and the FTF, meeting the Lisbon aims also requires an evaluation of the contents of the Lisbon strategy. It seems that we are also lacking a coherent strategy on the part of the European trade union movement on the issue of tackling the challenges that the EU is facing. The trade unions adhere to the aims but have no clear vision of the contents of such a strategy. LO and the FTF have therefore carried out a joint project which aims to provide suggestions concerning contents that may, if applied at different levels, bring the Lisbon strategy back on track.

The project focuses partly on economic policy and structural reforms in the EU and partly on the employment strategy, the open method of coordination and the Danish employment strategy. The project is being carried out jointly by the European Trade Union Institute, ETUI-REHS and with professional support from the Danish research group CARMA.

The project includes three reports, of which this is the first. These reports analyse the EU’s economic policy and structural reforms.

The first report includes issues and specific suggestions that need to be addressed if the Lisbon aims are to be realised. LO and the FTF therefore hope that this report and the upcoming reports may serve as an inspiration, both at the EU level and in Denmark, for the debates and initiatives that may provide the Lisbon strategy with the energy that it obviously needs.

Introduction

The last 100 years or so have brought substantial welfare gains to European citizens: stable jobs, improved health and safety at work, reduced working hours, social protection against risks and collective bargaining. Sustained productivity growth has been the backbone of this evolution, which has made the welfare society possible for more and more people. Historically, the period after the Second World War can be described as a ‘catch-up process’. The European industrial base had suffered enormously during the conflict. It was rebuilt and has served Europe well for many decades. But times are now changing. What kind of new challenges are we now facing and what will be the proper policy answers?

The EU has taken steps to change old industrial structures and replace them with more modern ways of working. The catchphrase is the ‘knowledge-based society’: less routine work and more jobs with high knowledge content. Whether this is true of most jobs is questionable. There is also a good deal of media hype that tends to overestimate the direct effects of globalisation. For instance, the scale of the off-shoring of work to the emerging tigers in India and China has been exaggerated. In fact, most industrialised countries in the EU have experienced a net gain from increased trade (OECD 2005a). Notwithstanding the unbalanced picture, competing with the newly industrialised low wage countries poses a significant challenge. Beyond the textile sector with its low productivity (which is not a fundamental economic threat to the EU) these countries are in some sectors already at the technological frontier. Is the EU ready for the changes ahead?

In Lisbon in 2000 the EU launched a strategy to prepare the EU for globalisation. It consists of three pillars: the economy, social cohesion and the environment. The aim is by 2010 to make the EU the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion. The overall long-term objectives of the Lisbon strategy are competitiveness, more and better jobs and social inclusion (HLG social policy 2004). The strategy is comprehensive since it comprises almost all the areas in which the EU operates. It thus covers everything from the completion of the internal market to labour market policy and loose cooperation on social and pension policy.

In March 2005 the Lisbon strategy reached the halfway stage. It was a moment to assess what had been achieved so far. Is the Lisbon strategy delivering? On a positive note more than six million jobs were created in the EU in 1999–2003. The Lisbon strategy also has the merit of converging policies. Today, in contrast to the situation before Lisbon, a common understanding has emerged on the importance of addressing people’s employability, lifelong learning, reconciling family and private life and Active Labour Market Policy (ALMP).

Another aspect of the Lisbon strategy is the completion of the Single Market. This is aimed at reducing trade barriers, and by this means increasing the EU’s competitiveness. The EU’s assessment of the internal market, determining the extent to which member states have reduced market rigidities, is quite upbeat. Against the benchmark of removing barriers to trade in the internal market the Lisbon strategy has proved efficient. The EU has liberalised energy, telecoms and financial services markets. Some member states have reformed their labour markets. However, although barriers are much lower today than at the launch of the Lisbon strategy, this estimation comes with a caveat: it is only a technical analysis. The real objective of structural reforms is improving living standards in the EU. By this measure, a less rosy picture emerges, exposing a policy paradox: the more structural reforms there are, the worse the EU economy tends to perform! Despite the Lisbon strategy, the EU is suffering from declining productivity growth and persistently high unemployment. Thus, if it can be proved that the EU is unable to realise the benefits of the reforms undertaken, legitimate doubts can be raised concerning the Lisbon strategy's promises about the five years leading up to 2010.

The purpose of this paper is to examine the types of economic and employment policy that might lead to the EU objective of full employment. To that end, we intend to analyse the present state of the economy and labour market policy in the EU. More precisely, this involves examining EU monetary, fiscal and budgetary policy, as well as employment and labour market reform. The analysis will also help to clarify whether the present EU policies really are oriented towards full employment, or are not rather paying lip service to it (to gain legitimacy from trade unions and civil society) to hide its (hidden) market deregulation agenda.

The paper sets out to answer two overarching questions:

1. How can demand-side stimulation be used to sustain job creation in the EU?
2. Is a policy that can combine flexibility and security a winning strategy for Lisbon?

The issue of the skills and educational needs of better qualifying workers for future job opportunities is beyond the scope of this paper. This also applies to the long-term financing of our pension systems: cooperation on pensions at EU level is still in an embryonic state. The implementation problems of EU cooperation in the various social fields (social inclusion, health and pensions) will be treated in a forthcoming report. In contrast, this paper will concentrate on policy content rather than process.[1]

The paper is organised in five sections. Section 1 sets out to explain and critically examine EU policies on growth and jobs. Section 2 takes the temperature of the EU economy, attempting an analysis of whether the expected results of EU policies have been met. Section 3 examines whether the EU objective of full employment *can* be realised or is subordinated to other economic policy goals, such as price stability, in the hierarchy of EU policies. Sections 4 and 5 are devoted to the modernisation of EU economic and labour market policies: section 4 draws up a framework for macroeconomic policy reforms, and section 5 outlines the revitalisation of EU labour market policies. By way of conclusion, the analysis is followed by concrete policy recommendations.

[1] The author is planning a paper on EU processes in employment and social policy, the so-called Open Method of Coordination.

1. The EU policy framework

1.1 The Lisbon strategy

The Lisbon strategy is the EU's response to a number of global challenges. Against the background of increasing unemployment in the 1990s the EU launched the European Employment Strategy (EES) in 1997. It later became an integral part of the Lisbon strategy, born at the European summit in Lisbon in 2000. It set out to answer two questions: How can we speed up the transition towards a knowledge-based economy with more and better jobs and more social cohesion?[2] How can we make Europe a more competitive and dynamic economy, able to create more and better jobs and greater social cohesion (Rodrigues 2002)? It is founded on three pillars: economic growth, social policy and sustainability.

The Lisbon strategy presupposes a linkage between the economy, employment and social cohesion. Does the evidence support this? Or is there a trade-off between security for workers and getting more people into gainful employment? We will return to this critical question in section 5.1.

All the areas in which the EU has competence are more or less attached to the broad Lisbon agenda. The strategy itself is composed of several political orientations (Rodrigues 2002):

1. development of an information society;
2. research and development policies;
3. enterprise policy;
4. economic reforms: liberalisation of the internal market;
5. macroeconomic policies;
6. a renewed European social model;
7. education policies;
8. active employment policies;
9. improved social dialogue;
10. modernisation of social protection systems;
11. social exclusion programmes.

The Lisbon strategy is embedded in a multifaceted policy-making framework. Monetary policy is supranational within the eurozone. National budgetary policies are coordinated at

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[2] The EU discourse, which takes for granted that we live in a knowledge-based society, is to some degree misleading. The implication of a knowledge-based society is that people must adapt – as if this was a natural law – to the global economy and new technology. To many jobs the concept is irrelevant (Crespo and Serrano Pascal 2004). For example, Sweden's most important export products are manufactured goods (cars, computers), wood, iron and steel. In fact, industries based on knowledge-intensive products are not increasing their share of total exports (Swedish National Board of Trade 2005).

European level on the basis of strict criteria and rules laid down in the Stability and Growth Pact. The EU budget is by definition supranational, but is limited to the member state contribution of 1% of GDP. Employment policies are coordinated at European level, but policy choices and implementation remain national competences.

In this first part we will assess the claim that structural reforms support more and better jobs. Can it be sustained, or conversely, can reforms which increase workers' insecurity be potentially harmful to the economy? We begin, however, with a brief introduction to the European Employment Strategy.

1.2 The European Employment Strategy (EES)

The Amsterdam Treaty of 1997 states that employment is a matter of 'common concern' to member states. Notwithstanding the ambitious wording, the EU has limited influence over member states' labour market policies. The EU acts as a coordinator of countries' labour market policies, setting objectives, issuing guidelines (common targets for combating unemployment) and making country-specific recommendations to member states. However, the financing and implementation of labour market programmes remain within member state competence. This way of leaving policy design and implementation to the national arena is officially called 'the Open Method of Coordination', a sort of management by objectives targeted at EU convergence.

The exertion of influence from EU level to national level is considerably affected by the lack of strong legal instruments in the EES, such as EU directives. This does not mean that there are no social EU directives, complementing the EES. Indeed, there are directives on health and safely at the workplace, working conditions, and so on, which sets a minimum floor of workers' rights at EU level. These have emerged with the integration of the internal market to encourage more mobility on the part of workers to take up a job in another member state. Other workers' rights have emerged as a result of agreements between the social partners at EU level. That said, the EES is constrained to do nothing which the member states do not wish to comply with.

Unlike in the field of hard law, where infringement procedures are occasionally initiated against member states that fail to comply with EU directives, the EES is dependent on the exertion of cognitive and normative influence on member states (see, for example, Jacobsson 2003). Countries which fail to observe EU recommendations on labour market reforms can be sanctioned. Pressure on individual member states can take different forms. The main instrument is peer review by other members. Peer review is the process by which a country is scrutinised with regard to its compliance with EU recommendations. Another source of pressure is public opinion: the fear of negative press coverage. However, press coverage of the EES in member states is poor; media attention is now virtually non-existent (Meyer 2003).

Since it started the EES has contributed to a paradigm change in the sense that while previously fighting unemployment was the dominant objective, now it is to raise levels of employment. The core policy is to get more people into employment.

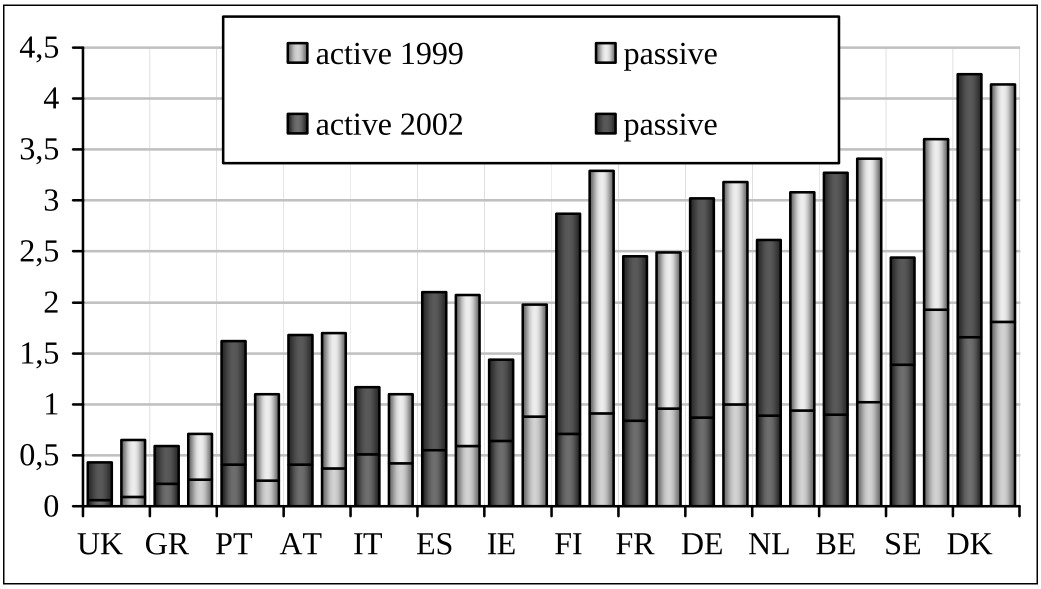
As we shall see in section 3 there is a lack of fit between the EES and EU-level macro-economic policy. EU macroeconomic policy has amputated the employment creation aspect of the EES, which is therefore mostly about converging ideas on Active Labour

Market Policy or ALMP (Watt 2004). We shall also keep our focus on this, bearing in mind that the EU has influenced national strategies in this field. We shall then turn to EU structural reforms.

1.2.1 Active Labour Market Policy

The findings on ALMP here draw on a recent publication by ETUI-REHS (Serrano Pascual 2004). Are ALMPs in the EU converging? The EES deserves credit for the fact that active labour market policies have increasingly been adopted in countries where they were previously unknown or used infrequently (Watt 2004). However, much of the language in the EES – such as adaptability, employability, flexibility, and so on – is vague. Every country can find positive employment of them in the national context. The various uses of the concepts in individual countries, as translated into policies, do not support the claim of convergence.

Figure 1. Expenditure on labour market policy, 1999 and 2002



Source: Benchmarking Working Europe 2005.

Figure 1 illustrates that Denmark spent most on active ALMP in 2002. One can also conclude that there is still no decisive shift from passive to active labour market policy in the EU member states.

What is the EU view on the ‘activation’ of individuals, which is part of the ALMP paradigm? It could be defined as the process of helping individuals to adapt to new economic situations. Personal adaptability is described as employability (personal competence which allows individuals to adapt to different situations). Yet, there is considerable uncertainty about what the EES aim of employability really means. What does it require of the unemployed? It could be the ability of a person to find his or her niche in the labour market (Jacobsson 2002). The EC has a definition which puts more pressure on workers: an individual’s capacity to keep a job, to change jobs and to build their own career path.

Clearly, this transforms unemployment from a societal problem into an individual problem. In fact, there is no established correlation at macroeconomic level between the skill level of the population and overall unemployment (OECD 2004). Nonetheless, training and education are obviously important for reducing labour bottlenecks, improving the matching of the skills of job seekers with the needs of enterprises. Furthermore, knowledge-intensive jobs which require more qualifications are more productive than low-skilled jobs. However, it is one-sided to explain unemployment entirely in terms of lack of personal skills (training, but also attitudes and values). The socio-economic causes of unemployment are also important. The minimalist understanding of the causes of unemployment is dominant also in the fight against social exclusion at EU level, within the framework of which paid employment is considered to be the best way of combating social exclusion. This downgrades unpaid work at home, however. It also tends to support the view that 'a job at any cost is better than idleness', which is the bottom line of the OECD Jobs Study (see Noaksson and Jacobsson 2003 for an in-depth study of the OECD's traditional approach to ALMP[3]). That tends to negate job quality, an important EU objective besides full employment. In conclusion, the EES is basically about finding ways to provide firms with a constant flow of skilled labour. There is a desperate lack of measures to increase demand for labour – to create jobs. Will EU structural reforms help in this?

1.3 The stronghold of structural reforms

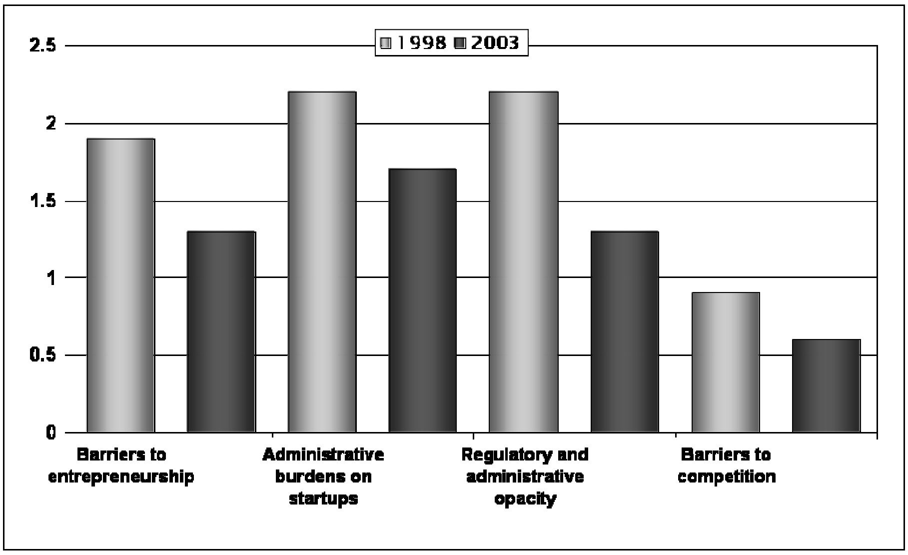
In 1985 the EU adopted a reform programme for the internal market. It boils down to removing all barriers to trade for people (labour), products, capital and services. Indeed, there is much evidence that deregulation has taken place on a broad scale (Conway et al. 2005):

- increased competition on product markets;
- the opening up of network industries to competition, telecoms, gas, electricity;
- privatisation of state-owned companies;
- effective regulation of EU competition;
- the single currency, which it is assumed will bring about price transparency;
- enlargement (EU-25) of the single European market, increasing competition.

It is an impressive list of reforms. All are assumed able to unlock the EU's growth potential. Studies show that structural reforms have increased competition on the product market (Conway et al. 2005). At first glance, this is positive. The removal of red tape and administrative obstacles to free trade is a good thing. We will soon return to the issue of whether they have produced the expected results.

3 The OECD Jobs Study will be revised in spring 2006; a softer approach to ALMP is one expected outcome (Noaksson and Jacobsson 2003).

Figure 2. Product market regulation in EU-15, 1998–2003



Source: OECD 2005a (scale 0–6 from least to most restrictive of competition).

If the results of the structural reforms were measured only in terms of barriers, they have been very successful. Barriers are much lower today than 20 years ago, be it the administrative burden or setting up a business in another EU country (Blanchard 2004). That is not the most appropriate measure, of course. The structural reforms are not an end in themselves: they should provide leeway for improving people's welfare, for example, by providing them with a decent job.

Let us now critically examine the theoretical beliefs underpinning the structural reforms in the labour market.

1.4 Decoding the structural reforms

The Broad Economic Policy Guidelines (BEPG) are a strategic EU policy instrument encouraging member states to take action to implement structural reforms. The policy content of BEPG has in principle remained broadly unchanged since 1993: inflation should be kept under strict control in accordance with the policy goal of price stability; the public budget should be close to surplus; wage policy should be moderate, with wage increases below productivity growth; benefit levels for the unemployed should be reduced; and tax wedges should be lower. The BEPG seem to have an agenda for employment and labour market policy in line with traditional OECD orthodoxy, different from that of the Employment Guidelines.

What is the precise link between forcing people to be more available than ever to satisfy the needs of the labour market (BEGL) and creating new and better jobs (EG)? In EU policy documents this is seldom clearly expressed.

One interpretation is that stability-oriented policies coupled with structural reforms create their own revival of domestic demand. How is that supposed to happen?

This reasoning seems to be pinning all its hopes on Say's law: if more people are available to take up jobs, the jobs will automatically be created by an increase in demand. This assumption seems at odds with the persistently high unemployment in the EU. The logic is, during periods of high unemployment, employers are able to drive down wages (the bargaining power of job seekers is weak) or pay the same wages and enjoy increased productivity. This encourages them to hire more workers (OECD 2005a).

This debate has led to policy recommendations (make it easy to hire and fire people) which are against the Lisbon objectives. The argument needs to be reversed: how can we return to a full-employment society without lower wages and lower working conditions? This is a crucial question which will remain at the heart of this report. However, first we must go deeper into the theoretical promises of structural reforms. What is the economic rationale behind EU structural reforms?

> Structural reforms such as dismantling job protection and unemployment insurance weaken the bargaining situation of workers and contribute to lower wage increases (or even wage cuts) and higher profit margins. Firms are then supposed to react to this by increasing investments and pulling the economy out of the cyclical slump. Related to this is the argument that lower price pressure from wage moderation will also cause disinflation, hence opening up the possibility for the central bank to cut interest rates and thereby stimulate aggregate demand. Firms which expect both higher profit margins and positive demand may then almost certainly be expected to increase investment. (ETUI-REHS 2005)

This logic is both applicable to both product market and labour market reforms. When rigidities to trade are removed, higher profits will automatically lead to dynamic investments. However, the EU is less orthodox than the OECD on deregulation. In contrast to the OECD, the Lisbon agenda does not directly recommend reducing the influence of collective bargaining institutions. One explanation is that the EU, in the absence of legally binding guidelines, depends on the social partners at national level to implement EU guidelines.

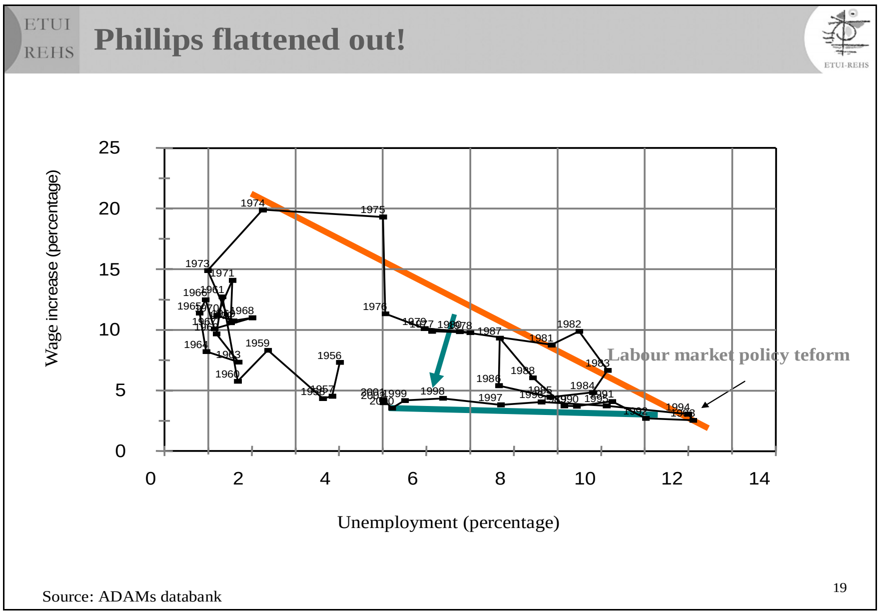
Let us now test the accuracy of two basic assumptions (the second basic assumption is dealt with in section 1.4.1 below) underpinning the structural reforms.

Assumption 1: Firms with high profits automatically invest

Big firms are experiencing historically high profit levels. ‘Firms have been net savers for odd years in the past, but a run of several years is highly unusual … if firms continue to save and consumer spending slows … then weaker growth will lie ahead. Could it be time, perhaps, to dust off the works of Keynes, and swot up on the “paradox of thrift?”’ (The Economist 9 July 2005).

The paradox of thrift refers to how – in the Keynesian model of the economy – an increase in saving reduces production and employment. This supposedly occurs because a decrease in spending leads to a decrease in employment, which leads to a further decrease in spending, which leads to a further decrease in employment, which leads to another decrease in spending, and so on. Thus, if people try to increase their saving, there will supposedly be a decrease in spending and a fall in employment and production. The paradox is that what is good for individuals (saving) can be bad for the economy. To offset these excess savings there are two policy choices: monetary or fiscal action. The Financial Times has lately opted for more flexibility on both: ‘large deficits may be needed to mop up excess saving’ (M. Wolf, 12 June 2005; see also 4.5.1).

Figure 3. The Phillips curve in Denmark



Critics of this view often make reference to the Philips curve, which is based on the assumption that in order to have lower unemployment we must accept higher inflation. The Philips curve assumes there is a trade-off between inflation and unemployment. However, evidence from Denmark and the UK, and the US in the 1990s, puts considerable strain on the empirical evidence underpinning it.

The figure shows how the Philips curve flattened out in the 1990s, as Denmark engaged in labour market policy reforms. Thus, the assumed trade-off did not occur. It also seems to be the case that inflation today is less volatile than it used to be (see 2.2).

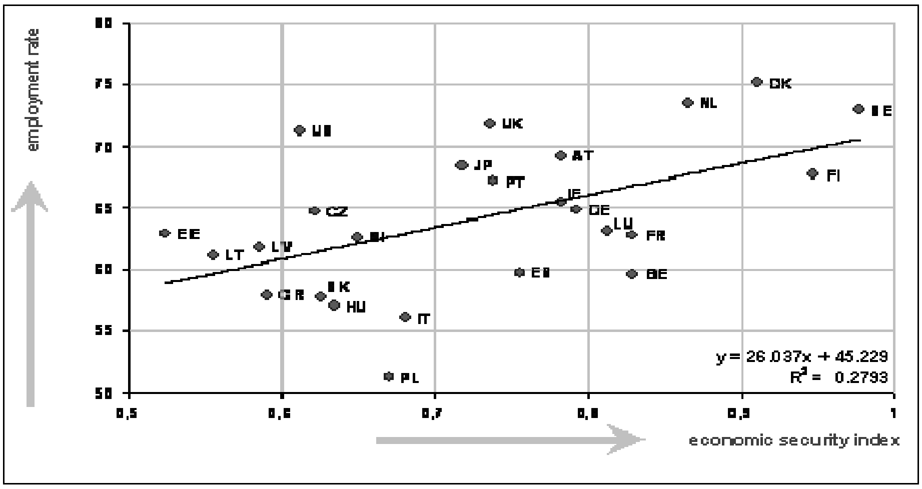
We return to the critical fact: demand in the economy is too weak. Firms are afraid that customers will not buy their products in sufficient quantities and refrain from investing. What might explain this reluctance to consume? Looked at from the other direction, why do people increase their savings? Conventional wisdom tells us that workers who feel increasingly insecure start to save more. Why should EU policy-makers worry about workers' feelings of insecurity?

1.4.1 The hollow promises of structural reform

Do workers' worries matter? The ILO has compiled data on economic security. Important indicators of economic security include protection against arbitrary dismissal, security against frequent changes in job content, the availability of adequate employment opportunities offered by state-ensured full employment (for details see ILO 2004).

The three Scandinavian countries provide the most economic security. If plotted against employment the result is positive.

Figure 4. Economic security and employment in EU countries



Source: Watt (2004).

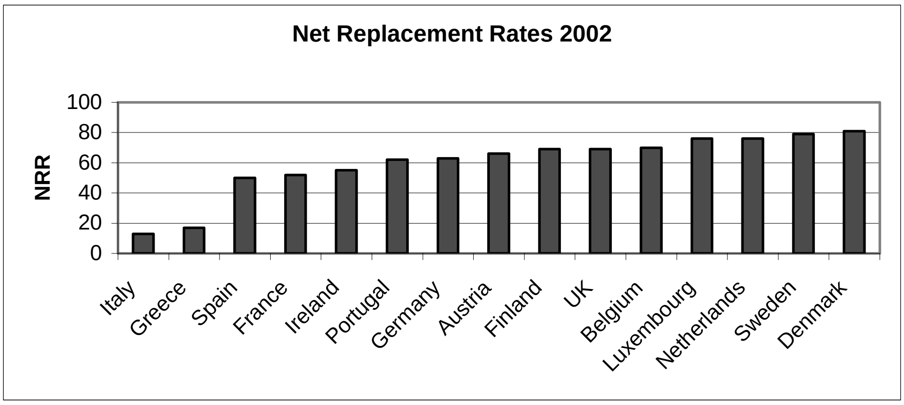
Thus, more economic security leads to higher employment rates! This reverses the conventional wisdom that deregulation creates jobs and growth.

Assumption 2: Dismantling workers' protection leads to higher profits for companies, and in the long run to full employment

We have already seen that the link between profits and an automatic increase in investment has been broken. Although that considerably weakens the rationale for structural reforms, we will not be discouraged from examining the correlation between deregulation of labour markets and growth and employment.

The literature disagrees on the effects of deregulation. A recent book challenges the conventional wisdom on the deregulation of labour markets (Howell 2005). The main argument is that in a flexible labour market (interpreted as a utopian 'perfect market') the low skilled would have a better chance of getting a job (with low wages, low benefit levels, and so on). Experience from the UK and the US strongly contests this conclusion. Since the early 1980s these countries have not enjoyed better outcomes than those of their counterparts in most of the rest of the OECD (ibid).

Figure 5. Unemployment benefits in the EU-15, 2002



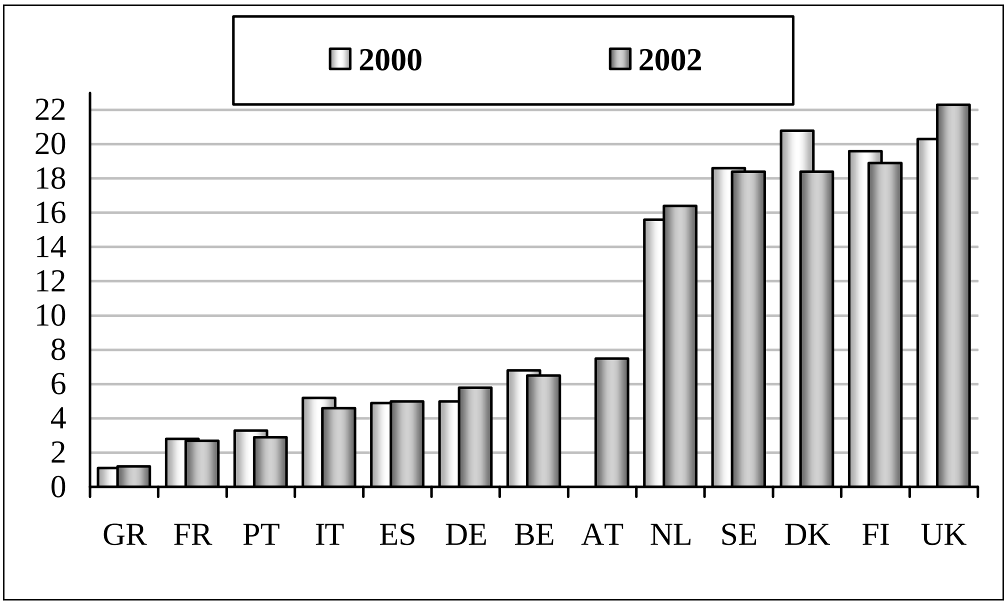
Source: OECD.

The UK model is based on the premise of work first (or short vocational training). Employees must take up any job and learn to be flexible. The UK has strong punitive measures. It provides the unemployed with information on job openings, and unemployment benefit levels are low. Social policies are kept to a minimum and linked to work incentives (tax breaks and fiscal policies). The motivation to take up a job is thus provided by punishing the unemployed, in line with the logic of the EU structural reforms. UK policy fundamentally assumes that market forces will yield social equity and efficiency. The shortcomings of this 'work first' approach are numerous. It assumes that displaced workers always find a new job which is more productive. However, the threat of poverty could push workers to take jobs for which they are overqualified. As a result, for the low-skilled it becomes difficult to find any job at all or they have to accept a wage which condemns them to the ranks of a US style 'working poor'.

By contrast, Denmark offers longer training programs to the unemployed. They receive relatively generous income maintenance, over an extended period of time. There is much emphasis on preventive measures. The general education system is regarded as particularly important. Denmark invests most in ALMP in the EU (Benchmarking Working Europe 2005). The large public sector is an indispensable part of the Danish model. Over three quarters of job training places are in the public sector. Danish flexicurity is based on both sticks and carrots. The stick – or punitive side – is that the unemployed are obliged to participate in ALMP. There is a corresponding duty on society to provide all unemployed with ALMP opportunities.

Furthermore, it would be impossible to retain adequate social protection with ineffective ALMP, resulting in higher unemployment levels (OECD 2005b). It is therefore unsurprising to see that Denmark has invested massively over the last decade in education and lifelong learning strategies, R&D and policies to reconcile work and family life. However, in 2000–2002 spending on lifelong learning fell, as illustrated in Figure 6.

Figure 6. Participation in education and training (% of population aged 25–64)



Source: Benchmarking Working Europe 2005.

In terms of employment levels, both the UK and Denmark are among the best performers in the EU. In terms of fighting inequalities and poverty among adults and children, however, Denmark is at the top but the UK is closer to the bottom. This has been achieved in Denmark without dismantling the Scandinavian model with its high tax rates, comprehensive social security system and universal unemployment benefits. In fact, the Danish system presupposes high tax and high employment levels. Thus, social reforms and economic reforms support each other and must go together. This disputes the claim of the Barrosso Commission that economic reforms must come first, and social reforms only thereafter.

In conclusion, the free-market orthodoxy of the IMF/OECD – and to some extent the EU – prescribing one-size fits all deregulation stands on very shaky ground. Blaming unemployment exclusively on ‘rigidities’ imposed by labour market institutions cannot be sustained on the basis of the available evidence (Howell 2005).

Returning to our initial question: Are structural reforms oiling the wheels of the economy or are they potentially harmful? A careful first assessment would be that structural reforms have been uneven, although it is extremely difficult to detect correlations. That said, in section 2 we will attempt to assess the EU economy.

BEPG is often described as a support instrument for the ECB. It is therefore important to examine the monetarist view of structural reforms which currently prevails in the ECB at the expense of Keynesian policies.

1.5 Monetarism versus Keynesianism

The ECB is pursuing a monetarist approach to monetary policy-making: the volume of money issued determines the major trends in the economy. The ECB can increase the money supply by cutting the interest rate, and keep it in check by maintaining or raising the interest rate. Inflation is believed to arise when the money supply exceeds demand for money. On this basis inflation is considered to be manageable.

According to the monetarist approach consistently maintained by the ECB, regulation of product and labour markets functions as a barrier to free trade. Unemployment would disappear if such ‘obstacles’ were removed. While the causal relationship between growth and employment remains undecided many economists believe that setting market forces free through deregulation and tax reductions will do the job. The model builds on the theory of the perfect market in which unemployment is denied: it assumes that the amount of money in the economy has the same effect on prices irrespective of level of demand or capacity utilisation. However, the model also assumes that the economy will always work at full capacity utilisation and full employment, if all rigidities are removed. Involuntary unemployment is thus explained by the excessive bargaining power of the trade unions: if the trade unions disappeared, so would involuntary unemployment.

The point of departure of Keynesian analysis is different. Capital accumulation – investments – determines the level of employment. This fundamentally challenges the ECB monetarist model in which wage moderation is the sole key to reducing unemployment. In a monetarist world, for every given real wage there is a fixed number of jobs in the economy. It is only a question of finding the equilibrium between labour demand and supply. This boils down to finding the wages (money) firms are willing to pay for a job, which in a perfect market is decided by the wages that workers will accept to perform the work. If there were no labour market institutions, or trade unions, workers would sometimes have to accept wages which were difficult to live on, so considerably increasing the working poor. The 'usual suspect' in monetarist theory is the trade unions, which protect workers' real wages from falling. This view is a travesty of the trade unions' real achievements in which wages play a critical role.

This US-led theory has several shortcomings from a normative standpoint. It leads to wage moderation and disparities, and less redistributive wages. By contrast, the Keynesian approach takes into account the effect of dynamic investment in the economy. If the minimum wage increases in line with productivity growth, the whole economy gains. In the Keynesian economy, in contrast to the monetarist view, workers also figure as consumers: wage increases translate into more consumption, which in turn is likely to create new jobs. In the monetarist model, however, an increased minimum wage induces firms to abstain from hiring and so unemployment increases. Put differently, the model sustained by the ECB explains unemployment increases as nothing more than sudden changes in demand for leisure (Stiglitz 2002). In the neoclassical view, reducing benefits will attract people to choose work before leisure.[4]

The difference between the Keynesian and the monetarist approaches hinges on their different views on price drivers. The monetarist assumes high price elasticity. In perfect competition world prices are transparent and highly competitive: if a producer increases prices, customers will turn to his competitors.

The Keynesian approach considers prices to be less competitive and less transparent to customers. As early as the late 1970s, before globalisation had really got under way and at the beginning of the mergers and acquisitions process which has created huge global corporations, a trade union report predicted the challenges of the future, describing pretty much the situation we are facing today:

> Pricing policy is also very dependent on the position of a firm in the market, i.e. on the extent to which it dominates the market, on the degree of product differentiation, on the development of price leadership and so on. Large firms, and especially transnational ones, often have a dominating position, and medium sized and small firms are tied to them through price leadership, subcontracting, and the division of markets and in other ways. (ETUI 1979)

As far as customers are concerned, it is difficult and time consuming to compare different brands as regards quality and price, although it has become easier with the Internet: there are now many search engines which in the blink of an eye provide customers with price comparisons of different goods and sometimes also independent quality assessments ('customer reviews'). In brief, the Keynesian approach considers prices to be 'sticky' and that firms have a number of ways of maintaining price levels, despite falling demand for their products. Firms prefer to maintain prices (which is possible if there is low effective competitive pressure) even if this results in shedding labour.

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[4] The measurement of changes in working hours due to tax rates depends on the assumptions one makes about the strength of preferences for work and leisure respectively. The cross-country relationship between a decrease in hours of work and an increase in tax is weak (Blanchard 2004).

The purpose of the discussion so far has been to highlight the monetarist view of wages. Wages are considered a rigidity: if they were reduced, more jobs would be created. This is extremely one-sided and, as we have seen in our explanation of the hidden rationale of structural reforms, potentially harmful to economic sustainability.

In conclusion, investment and consumption are two sides of the same coin. One is not possible without the other. Markets have been deregulated, possibly resulting in stronger competition. However, harsher competition seems to have fuelled workers' worries. The data presented in section 1.4.1 support a correlation between feelings of security and high employment rates. In section 2, we will take the temperature of the EU economy (especially the eurozone). We need more empirical evidence to put flesh on our hypothesis. Can the negative influence on the economy exerted by structural reforms, combined with the ECB's primary concern with price stability, and the excessive budgetary discipline of the broad economic policy guidelines (BEPG) and the Stability and Growth Pact (SGP), be sustained? In short, is this a flawed policy mix?

2. Taking the temperature of the EU economy

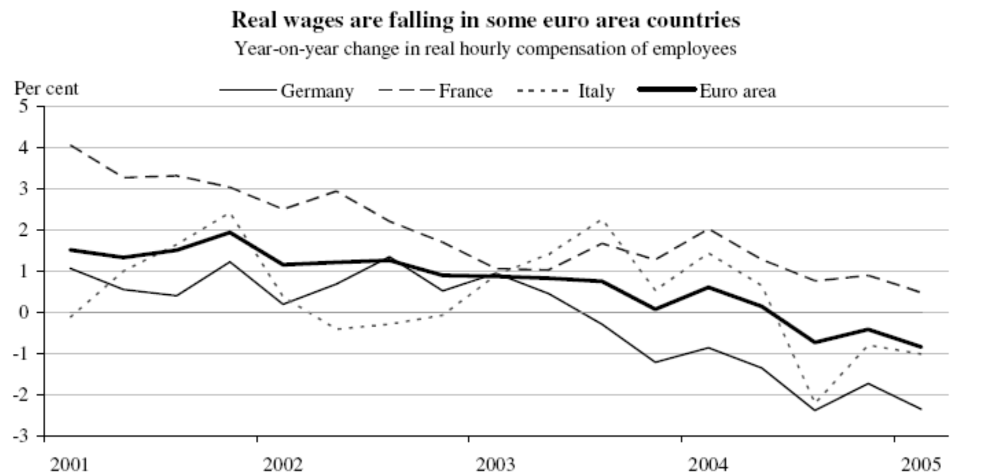
We will begin by looking at some of the variables impacting the demand side of the economy, which is important for growth and jobs. These include: real wage development, inflation prospects, exchange rates, the difference between actual and potential growth, the propensity to save among companies and consumers, productivity growth, trade balance, and so on. All these matter for creating an economic environment which promotes domestic consumption, the main driver of investment, and consequently increases EU growth prospects. Let us outline current trends, based on the latest available facts.

Our aim is to trace the effects of the considerable structural reforms implemented over the last two decades. Have the promises of increased growth and more and better jobs been realised since the start of the Lisbon strategy in 2000?'

2.1 Wage development

Despite the widespread belief that European labour markets are rigid and wages inflexible, real wages have been falling since 2003 in the euro area. This has eased the expected inflationary risk of increased oil prices. No tendency towards wage inflation is discernible in the statistics. On the contrary, hourly earnings have decreased considerably, resulting in negative real wage growth (nominal wage growth minus inflation) in the fourth quarter of 2004.

Figure 7. Real wages in selected countries and the eurozone



Note: Real compensation of employees is computed as total compensation of employees in the economy divided by the total number of hours worked and deflated by the private consumption deflator.

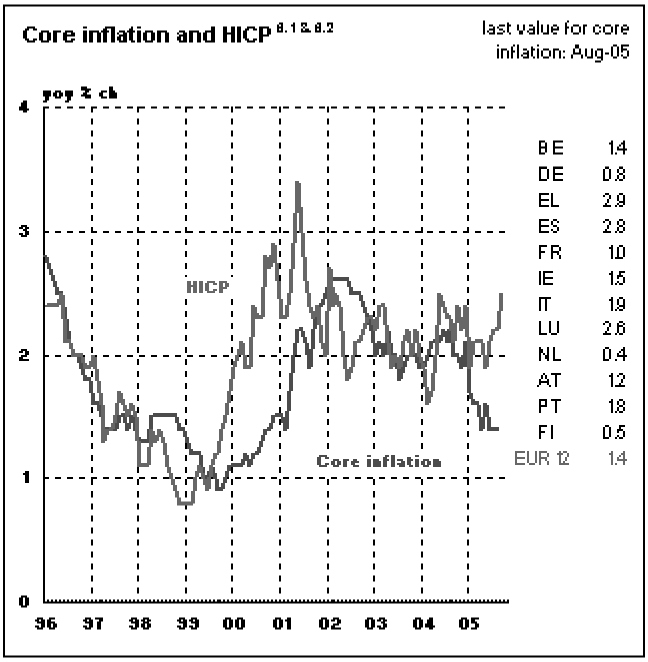
Source: OECD Economic Outlook 77 database.

Negative real wage development is especially pronounced in Germany. The eurozone has experienced negative real wages since the beginning of 2004. No wonder domestic demand and household consumption remain extremely weak (see sections 1.4–1.6). In order to offset the depressing effects of wage moderation, the ECB must cut interest rates in order to stimulate demand. Otherwise, there is a risk that the eurozone will drift into deflation (Macroeconomic Policy Institute 2005).

2.2 Inflation

Between 2003 and the end of 2004 core inflation remained at 2%. However, the most recent developments confirm a rapid fall to 1.5%. The prospects of falling core inflation have been strengthened (negative output, unemployment, sluggish domestic demand). The OECD predicts core inflation of around 1.25% or below in 2006. The risk of disinflation is growing. This is significantly below the ECB's self-imposed price stability objective of 2% inflation or below. What are the risks of disinflation? The case for using monetary policy – cutting or increasing the interest rate – diminishes when inflation is low or close to zero. Disinflation is explained by falling demand (investment becomes expensive if there is no inflation) and thus falling prices. The problem with a low real interest rate is that investors and consumers expect the real value of debts to rise. Some companies will experience bankruptcy and bank lending without sufficient guarantees could trigger a bank crisis. Deflationary economies experience difficulties returning to a higher growth track, as clearly shown by Japan's depressed economy over the last 10 years.

Figure 8. Inflation in the EU, 1996–2005



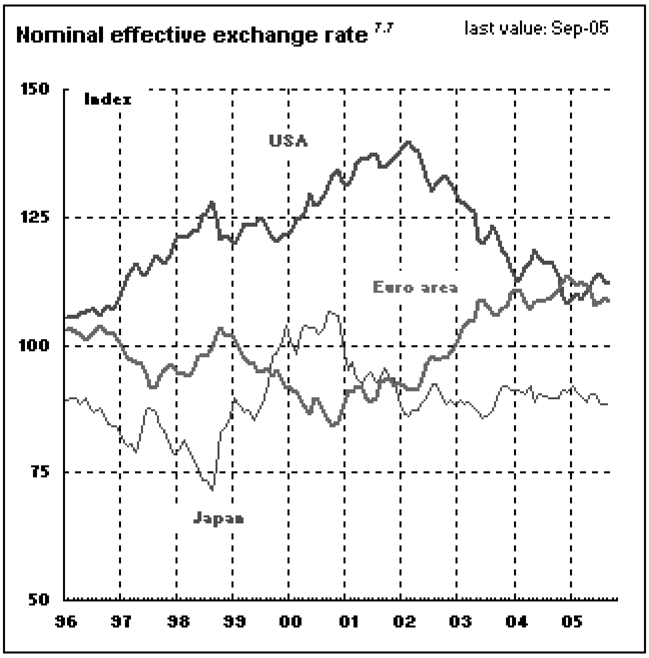
Notes: HCIP: Harmonised index of consumer prices, national CPI until 1996.
Core HICP: Harmonised index of consumer prices, excluding energy and unprocessed food.
Source: Ecofin website, euro area indicators.

In its latest forecast the OECD predicts that oil prices will stabilise at 48 dollars per barrel at the end of 2005 (OECD 2005a). However, if – as is likely – currently rising oil prices remain more or less stable, they will negatively influence the medium-term growth forecast for the EU. Besides, core inflation remains low and overall labour costs, once productivity is allowed for, are not causing inflationary pressures (IMK 2005). In fact, if oil prices contributed to depressed consumption it would constitute a greater worry than a potential limited rise in inflation.

2.3 Exchange rates

The euro has been appreciating clearly against the US dollar for a number of years. This means that EU products have become more expensive to import for other countries, while imports to the EU have become cheaper. This raises doubts about the advisability of relying on export-led growth in the EU. International competitiveness is obviously offset by the appreciation of the euro. It should be stressed that EU exports to the rest of the world are limited to 15% of GDP. This means that 85% of eurozone GDP relies on domestic demand. Therefore, in order to be more independent of growth in the US (which means more imports from the EU) an alternative macroeconomic approach is needed to stimulate the European economy by means of lower interest rates.

Figure 9. Nominal exchange rate in the eurozone, 1996–2005



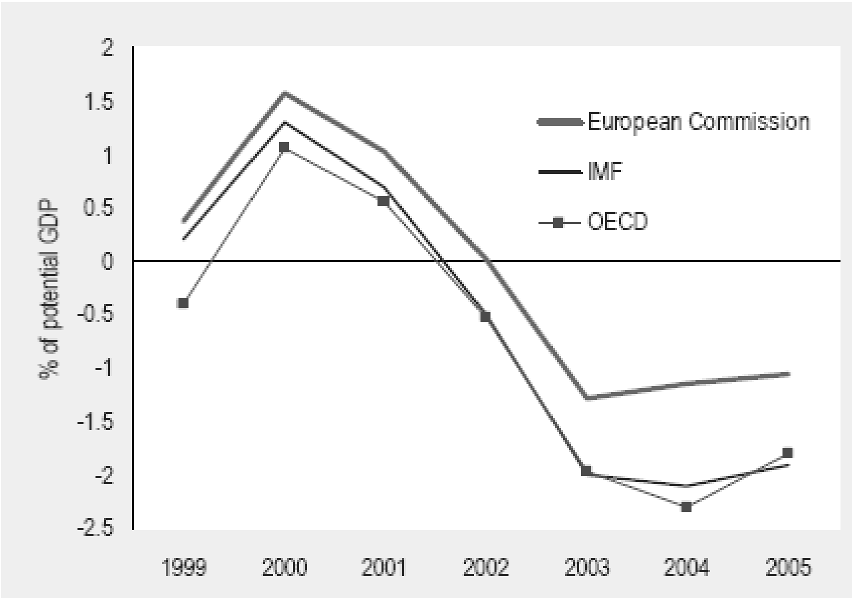
Source: Ecofin website, euro area indicators.

This would serve a twofold purpose: it would ease the upward pressure on the euro and stimulate domestic demand (Benchmarking Working Europe 2005). The downside of being too dependent on export-led growth is its uncertainties. It will only work as long as there is sustained demand in other countries, especially the US, for EU products. It is therefore vulnerable to reduced spending due to a higher rate of savings in the US (although at present savings rates are historically low).

2.4 Actual and potential growth

An output gap (the difference between actual and potential growth) in the economy signals that it is not operating at full capacity. Put differently, ‘potential growth’ or spare capacity in industry might be described as the ‘speed limit’ of the economy (going beyond the speed limit causes trouble, such as rapidly rising inflation). The OECD estimates the output gap for the eurozone at between 1.5% and 2% for 2005. For 2006 the output gap for the eurozone is estimated at –1.9%. If we look more closely at actual GDP growth, it has been scaled down to an estimated 1.2% for 2005, while potential growth for 1998–2006 is 2.0% (OECD 2005a, 77).

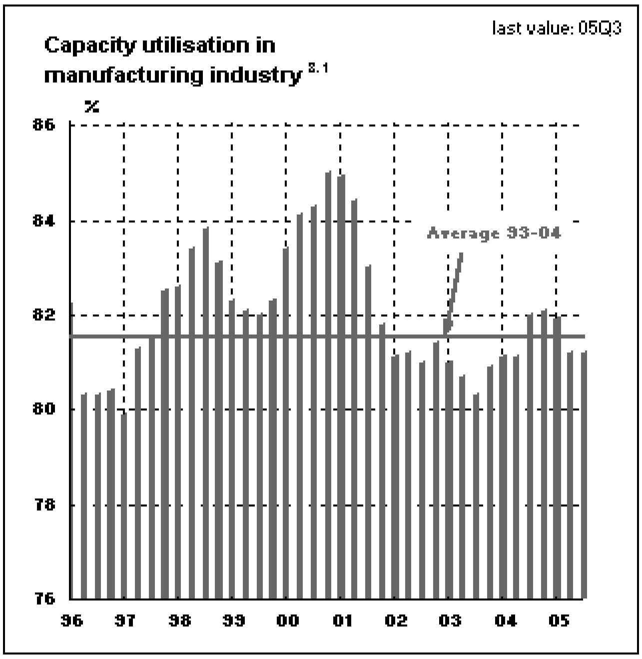
Figure 10. Output gap, eurozone



Note: OECD data is the spring forecast., based on potential GDP.

Source: The EU economy: 2004 review.

Figure 11. Capacity underutilisation in manufacturing industry



Source: Ecofin website, euro area indicators.

This output gap is confirmed by the underutilisation of capacity in industry.

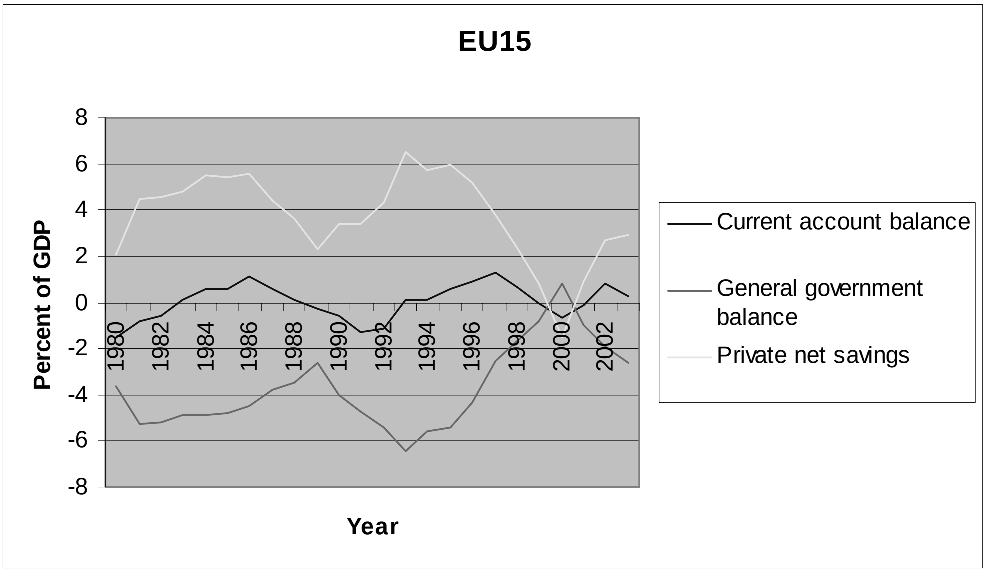
Manufacturing in the eurozone is operating at 82% of full capacity. Investment will therefore remain weak. Enterprise investment decisions depend primarily on adequate domestic demand. They also depend on psychological factors, such as workers' feelings of economic security, based on job and wage prospects (ILO 2004).

2.5 Current account balance

The European debate has focused a great deal on the budget deficits of member governments. Countries breaching the so-called Stability and Growth Pact – which aims at maintaining a balanced or surplus budget – constitute one example. Countries that show excessive budget deficits are described as seriously undermining economic stability in the EU.

However, if we take into account the propensity to save of households and firms, the picture changes fundamentally. Exclusive concentration on government spending provides at best a one-sided analysis.

Figure 12. Current account balance in the EU-15, 1980–2002



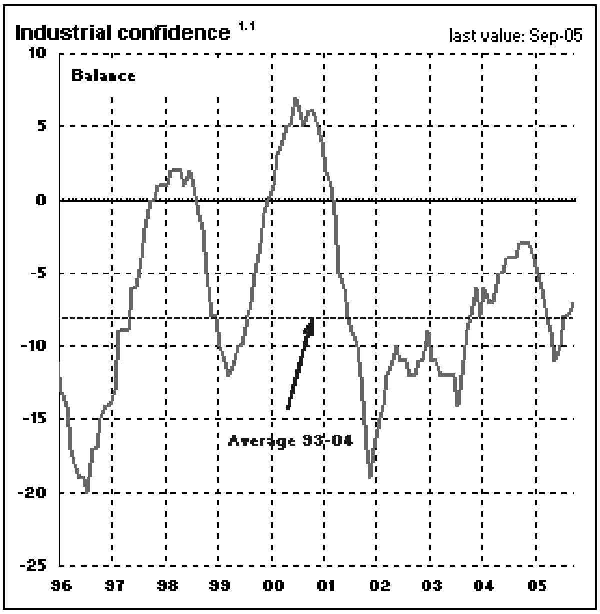
Source: A. Larsson, speech at conference '10 years in the EU – effects on Swedish labour law and labour market', Working Life Institute, 19 January 2005.

Figure 12 shows that since 1993 the current account balance has been positive (with a brief exception in 2000). There is thus a total surplus for most years, especially in countries such as Germany and France, which have had problems with government budget deficits. In a domestically depressed economy it is not sound practice to require a higher surplus in the current account balance. This will be at the expense of growth and jobs. The policy implication of this is that it is important to improve the investment climate, encouraging firms and households to start consuming some of their savings. That would boost the economy as a whole (OECD 2005a).

2.6 Industry and consumer confidence

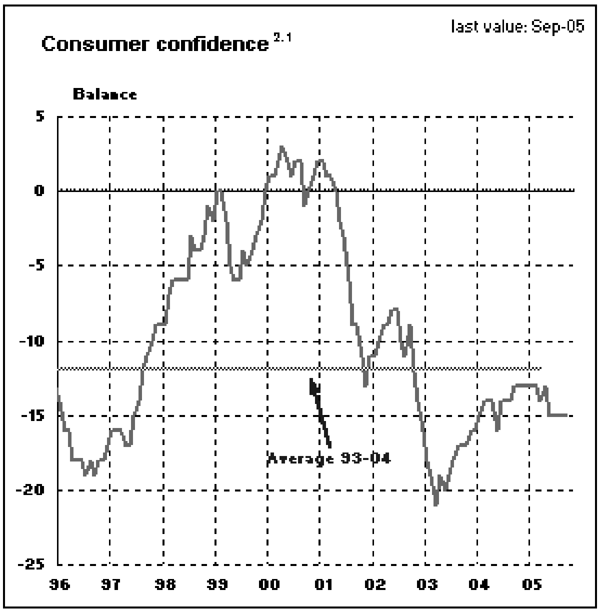
Figures 13 and 14 speak for themselves. Industry confidence has been falling in 2005, and currently stands at around –7%. Consumer confidence is very low at –15%, equal to the depressed level of 1997. Firms and consumers are saving because they do not have faith in the future. Firms do not expect increasing demand for their products. Workers/consumers are insecure about their jobs and wage prospects, further depressing domestic demand. The policy trap is that every country is waiting for the others to take responsibility for stimulating aggregate demand. In this way, no one takes responsibility. This ‘prisoner’s dilemma’ is put under further pressure by the Stability and Growth Pact which puts a limit on public investment.

Figure 13. Industrial confidence in the eurozone, 1996–2005



Source: Ecofin website, euro area indicators.

Figure 14. Consumer confidence, 1996–2005

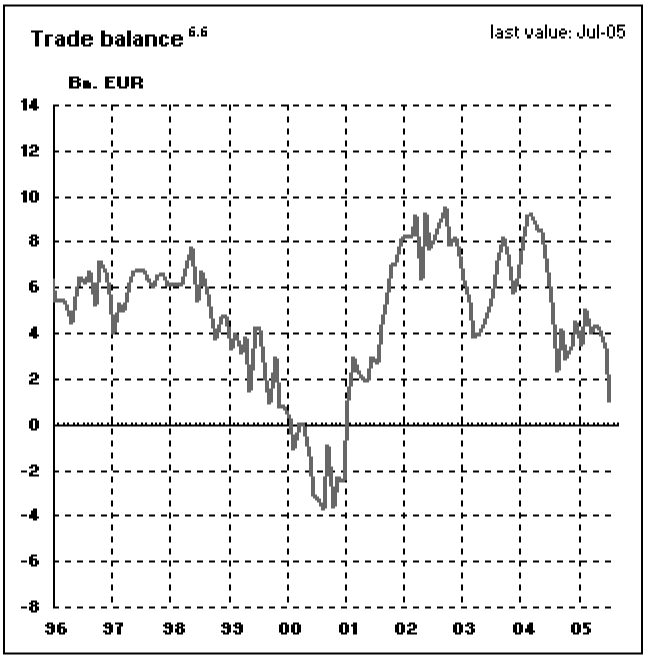


Source: Ecofin website, euro area indicators.

2.7 Trade balance

The EU is still competitive when it comes to the trade balance. More products are exported than imported. The EU has had a trade surplus since 2000, although the trend has been declining since 2002. The trade surplus cannot be used as an isolated measure of competitiveness, however. Arguably, the ECB's monetary stance (not cutting interest rates further despite persistent low growth) has depressed European domestic demand for imported products. This can be verified by measuring the share of domestic production going to foreign producers (Morley et al. 2004). This share has not been declining in recent years. Germany is still an extremely strong competitor on world markets, measured in terms of the trade balance.

Figure 15. Trade balance, 1996–2005

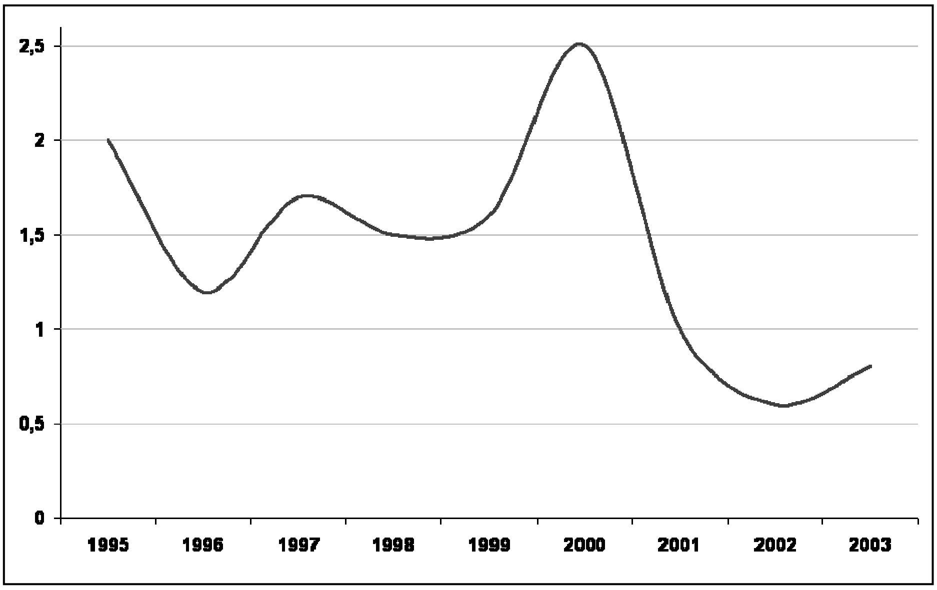


Source: Ecofin website, euro area indicators.

2.8 Productivity growth

Productivity growth has been slackening in the EU since 1995. It is an important measure of competitiveness since higher productivity growth permits higher living standards. However, changes in productivity depend strongly on economic cycles. At the beginning of the recovery from a recession productivity tends to increase. Companies make more use of their existing labour force, and wait until there are clear signs of an upturn before hiring new workers. In contrast, at the beginning of a recession productivity tends to decline due to falling sales. Companies hoard labour for some time until the recession starts to take hold. At this point, redundancies are overwhelmingly likely, which increases productivity again. Due to the importance of economic cycles, it is necessary to focus more on the underlying productivity trend.

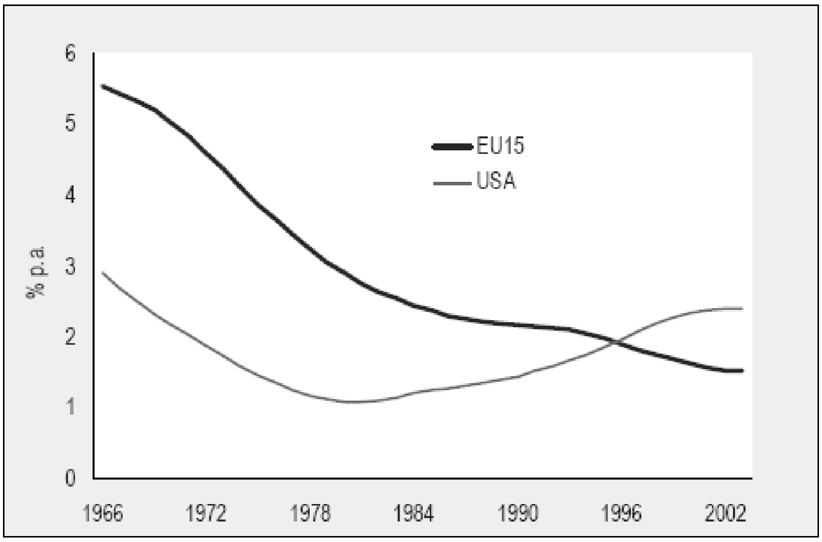
Figure 16. Productivity growth rate in the EU-15, 1995–2003



Source: Employment in Europe 2004.

The long-term productivity trend illustrates a catch-up period for the EU in relation to the US stretching from the 1960s to the 1990s: the EU started from a much lower level after the Second World War. However, since 1996 productivity growth has been showing clear signs of weakness, especially if one contrasts the eurozone with the Nordic countries. Average annual labour productivity growth in the eurozone was 1.2% between 1995 and 2003; by contrast, the Nordic countries had average productivity growth of 2%. In other words, their growth outpaced the eurozone by 70% (Employment in Europe 2004).

Figure 17. Long-term labour productivity per hour (growth trends)

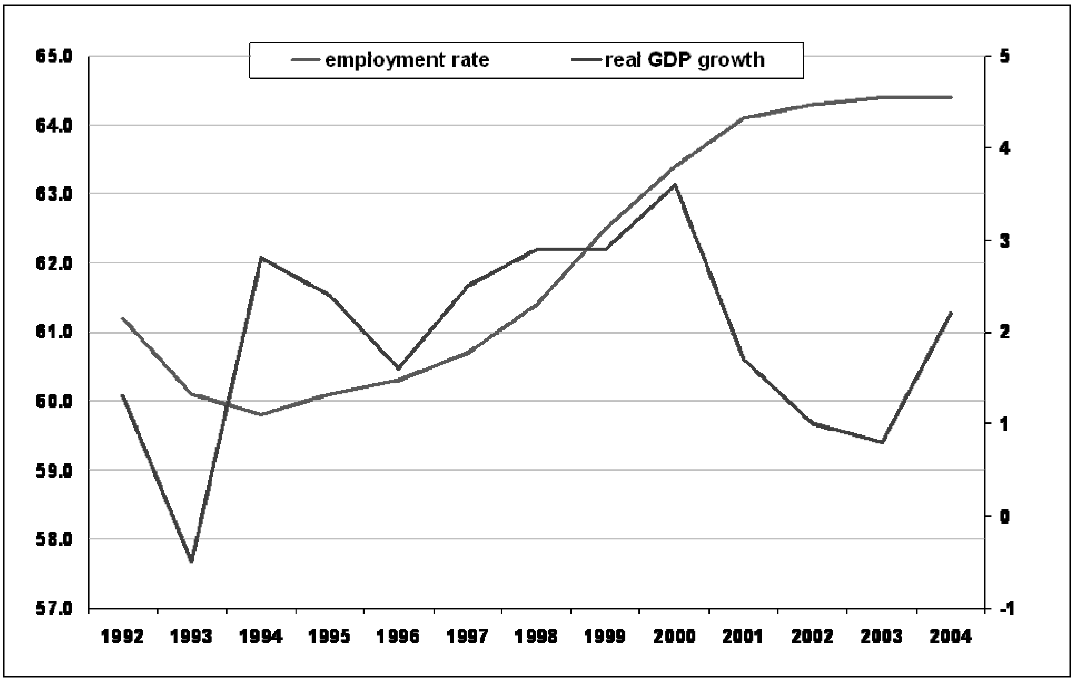


Source: European Commission, Economic Papers 221.

Relying on productivity alone can be misleading; it is also important to look at employment levels (Morley et al. 2004). In an economic slowdown, it would be equally good to have either high levels of productivity in goods and services and high levels of unemployment, or a high employment rate even if productivity levels are lower. It depends on the ratio between level of productivity and employment rate and the level of output (how fast the economy is growing).

Since productivity growth is important for raising living standards, which in turn is measured in terms of real GDP growth, they are mutually influential. That is illustrated in Figure 18 in which real GDP growth has a very similar curve to productivity in Figure 17. A country’s competitiveness is better measured in terms of a combination of GDP growth *and* employment. Normally, they follow each other over time. One interpretation of Figure 18 is that, although from 2000 the EU entered a low growth period, new jobs have been created! There is no evidence to support jobless growth in the EU (productivity growth not accompanied by employment increase). What can explain the employment increase? One explanation is that Europe has experienced a long period of wage moderation. This has increased incentives to hire more people rather than to invest in equipment (Benchmarking Working Europe 2005). However, this is not an argument for pursuing more wage moderation policies in the EU. On the contrary, although one or two members of the euro area may be able to take advantage of the demand dynamics arising in the rest of the euro area by moderating wages, if all countries tried to apply it simultaneously it would fail. A pan-European wage-cut strategy would lead to a collapse in internal euro area demand and the very basis of growth would disappear.

Figure 18. The link between economic growth and employment



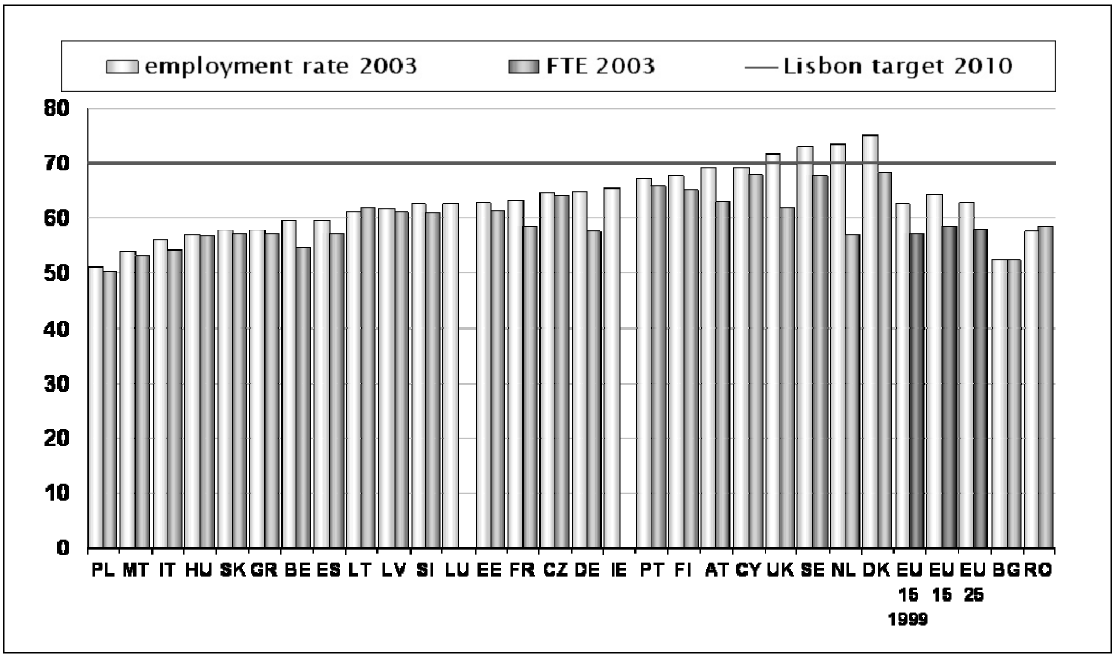
Source: Benchmarking Working Europe 2005.

Furthermore, companies have been hoarding labour in countries experiencing a depressed economy and lower sales in the hope of rapid economic recovery. Figure 18 represents the diversity of the EU countries. Economic growth has diverged significantly during the five years of EMU (Morley et al. 2004).

2.9 Employment rates

Figure 19 shows that the Scandinavian countries score high on full-time employment rate. These countries already meet the Lisbon target of a 70% employment rate by 2010. Some countries – notably Germany, the Netherlands and the UK – have a lot more part-time workers. That is worrying for these countries in view of the corresponding low financing of future pensions. In addition, low fertility rates are further aggravating the prospects of sustainable economic growth in some member states in a longer time perspective.

Figure 19. Employment rates and full-time equivalents, 2003



Source: Benchmarking Working Europe 2005.

2.10 How sick is the EU economy?

Our starting point for taking the temperature of the EU economy was an examination of whether structural reforms are tending to depress consumer confidence. Based on the economic facts presented, the assumption seems well founded. Flexibility without compensation in terms of more security means increased insecurity for workers. The lesson from this is that deregulation can have negative effects on the economy. Structural reforms[5] seem to be part of the EU's unemployment problem rather than part of the solution.

We also broached a wider question: have the promises of increased growth and more and better jobs been realised since the launch of the Lisbon strategy in 2000?

[5] The ETUC is positive concerning structural reforms under certain conditions: macroeconomic policy should promote growth and structural change should be promoted in a socially acceptable manner. The ETUC supports reforms that could produce higher productivity growth and, ultimately, living standards (ETUI 2002). Our analysis seems to show that EU structural reforms are neither very helpful in inducing growth nor socially acceptable.

In humans, body heat is regulated to provide a normal temperature of 37 C. Similarly, there seems to be no risk of the European economy overheating. There is a negative output gap and core inflation is on a downward trend. Real wages are falling in some EU countries. Households and firms are saving. Workers are feeling insecure about their employment prospects and future wage developments. Firms are experiencing historically high profits over a sustained period of time. Clearly, these profits have increased – dramatically – more than investment (OECD 2005a). Will it get worse before it gets better? The OECD expects only 1.2% growth for the eurozone in 2005, and the long-term prospects are gloomy (OECD 2005b).

On a positive note, the EU has a trade surplus. It is a central competitive strength that the EU is selling more to non-EU countries than it is importing. Furthermore, people are saving a lot of their disposable income, which means that *if* they started to spend the whole economy would gain. Employment rates remain stable. All these factors create scope for more expansionary macro policies.

There seems to be a constant delivery gap between the EU's desirable outcomes (full employment and growth) and EU policies (ECB, BEPG, SGP, and so on). The objective of full employment requires both a supply- and a demand-side policy. A balance must be struck between the persons available to take up a job, and the number of jobs available. This argument has not (yet?) entered the discourse of the EU Commission. Instead, the current policy mix leans too heavily to the supply side.

Take a concrete example: Germany has had a sluggish economy in recent years, while continuing to be a strong exporting country. Most experts agree that the main problem is not productivity, but a lack of effective domestic demand. Germany would need either a monetary or a fiscal boost to stimulate domestic consumption.

Considering the first alternative, an expansionary fiscal injection, sluggish economies sometimes need a 'kick start'. Under current circumstances, fiscal deficits will not crowd out private spending, but rather encourage it, by sustaining income and expenditure (Wolf 2005). Germany is already running budget deficits exceeding the boundaries of the Stability and Growth Pact, however. Fiscal policy is therefore not a possibility. The other alternative, a rate cut by the ECB, also seems to be ruled out. The ECB represents the eurozone as a whole and has chosen to pursue price stability (marginalising secondary objectives such as economic or employment prospects).

Furthermore, a number of legal and political constraints have greatly reduced the capacity of national governments to influence growth and employment (Sharpf 2002).[6] The only remaining government instrument (to return to higher growth and higher output) is to make labour cheaper for employers. In Germany this has taken the form of the so-called Hartz reform. In substance, it has penalised the unemployed and cut labour costs. People previously on unemployment benefits have been put on much lower social benefits. However, if labour costs are not the problem, a labour cost reduction will not help, but

[6] Scharpf refers to the liberalisation of internal market regulations. These policies 'have eliminated the possibility of using public sector industries as an employment buffer; they no longer allow public utilities and the regulation of financial services to be used as tools of regional and sectoral industrial policy; and European competition policy has largely disabled the use of state aid and public procurement for such purposes' (2002), p. 648.

only deepen the crisis (Horn 2005). A recent assessment confirms this: the Hartz reform has been costly *and* has failed to create many new jobs (The Economist 2005). In conclusion, no substantial benefits have come from the Hartz reform. One often neglected drawback, however, is the further deterioration of domestic demand. Without sufficient demand prospects (the main driver of investment) profits will continue to increase at the expense of growth and jobs.

In contrast, the Nordic countries have successfully combined high employment rates and low unemployment with high productivity growth. It is misleading to speak of all EU countries as a homogenous group. It should be born in mind that the economic problems by and large relate to the eurozone.

In conclusion, the euro area seems further away than ever from its potential peak. In addition, the EU policy mix tends to be counterproductive and requires serious reform. Expansionary macro policies are needed (contributing to effective demand and job creation).

Section 3 will describe the hierarchy of rules governing European policies. It will illuminate the existing hierarchy which is limiting the realisation of EU policy objectives. Is the institutional setting an obstacle or a catalyst in relation to full employment in Europe?

3. The EU hierarchy of rules

The background to the current hierarchy of rules lies in the liberalisation of the internal market. The European Single Act 1985 (SEA) clearly defined the internal market as without internal frontiers: within it the free movement of goods, persons, services and capital is ensured. Opening up to competition in the EU internal market was not unproblematic. The different legal systems and welfare traditions appeared to be obstacles to market liberalisation. Great efforts were put into the deeper economic integration of member state economies. As we will see, this spilled over from purely economic reforms to new initiatives to increase EU employment and social policy convergence.[7]

3.1 European Central Bank

Let us start with economic institutional innovation and the establishment of a central bank at European level, replacing national central banks for the eurozone. The ECB is a supranational independent body set up to govern eurozone monetary policy. Price stability is its primary objective, overshadowing – in the statute – a number of secondary targets, including employment. More precisely, the ECB aims at inflation rates of below, but close to, 2% over the medium term.

The ECB is arguably the most independent central bank in the world. The famous independence article contains the following:

> neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. (Article 7, Statute of the ECB in the protocol of the Maastricht Treaty, 1992)

The ECB's independence surpasses that of the Bank of England, the former Bundesbank and the Federal Reserve by a wide margin. The latter are established under simple law, while the ECB has its independence enshrined in the Maastricht Treaty and is virtually impossible to change (FT, 3 June 2005). The ECB is subject to no control. The Federal Reserve is under an obligation to pursue a strategy to support price stability and maximise growth and employment. The Federal Reserve has set no inflation target, as opposed to the ECB, since that is seen as a decision for politicians, not economists.

The main problems of the ECB have been precisely formulated by Joseph Stieglitz: 'it is a political failure to delegate decision-making to an independent central bank which is unrepresentative of the various groups affected by macro-policy, which is dominated by financial interests and which pays little attention to employment' (Stiglitz 2002, 19). It boils down to a question of economic policy-making and democratic legitimacy: Is it plausible to delegate decisions on people's employment prospects to non-elected, non-accountable economists at the ECB? Indeed, the present situation makes a change in ECB policy exceptionally difficult.

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[7] However, it is disputed whether the employment guidelines are a spillover effect of the integration of the internal market or an objective, developed on its own merits (Jacobson 2002).

3.2 Broad Economic Policy Guidelines

With the Maastricht Treaty in 1992 the EU embarked on economic and monetary union, leading to a common monetary policy, an independent European Central Bank and a single currency, the euro. In line with increased economic integration there was extensive innovation of EU instruments to support the work of the ECB. In 1993 the so-called Broad Economic Policy Guidelines (BEPG) were born. It is a treaty-based instrument (EC Treaty 1992, Art. 98, 99) originally aimed at contributing to macroeconomic stability with a view to boosting growth and employment in the EU. BEPG shifted focus when Economic and Monetary Union (EMU) was born. It developed into the key economic policy instrument for ensuring that the ECB arrives at its objective of price stability. This implies much wider scope and influence for BEPG: the E(M)U's economic situation as a whole, structural reform, and so on. Since 1999 it has contained a country-specific part.

> As a general instrument for coordinating economic policies, the BEPG should continue to embrace the whole range of macroeconomic and microeconomic policies, as well as employment policy in so far as this interacts with those policies. (Article 39, spring summit conclusions 2005)

3.3 The Stability and Growth Pact

The member countries aiming to join EMU must meet the Maastricht criteria for convergence of economic policies: low inflation, stable public finances, stable exchange rate against the euro and low long-term interest rates. There was a risk that these rules would be abandoned by countries after entering EMU. The Stability and Growth Pact (SGP) was then insisted on by Germany to ensure that fiscal policy would not be rapidly eased after short-term manipulation to meet the Maastricht criteria for euro entry.

The core commitment of the SGP is to set the medium-term objective of budgetary positions close to balance or in surplus, which will allow member states to deal with normal cyclical fluctuations while keeping the government deficit within the reference value of 3% of GDP. Some countries, notably Germany and France, have been criticised by the EU Commission for deficits exceeding 3% of GDP, year after year. This triggered a debate on whether the SGP was flexible enough for countries with a depressed economy. The outcome of this debate in March this year was a revision of the SGP. The 3% deficit value was maintained, but made flexible for countries in 'exceptional circumstances'.

'Exceptional circumstances' in the new interpretation are any negative growth, as well as a protracted period of very low growth. In this situation a country can temporarily exceed the 3% budget deficit (yet remaining close to the reference value). The medium-term objective is for the budget balance to fluctuate between a surplus or deficit of 1%. So, besides 'exceptional circumstances' the Commission can also take into account the volume of investment when conducting the excessive deficit procedure. This is positive, as it will allow room for more public investments. There is also a special role for pension reforms, targeted especially at the new member states. It will ease the pressure on these countries to reform their pension systems, while still remaining eligible to join the euro.

Reform of the SGP is a step forward (for a discussion of the revision see Watt 2005). It means that persistent unemployment may be fought by spending more to stimulate demand for more jobs. Thus, growth-unfriendly policies which promote a 'do nothing and maintain stability' approach are now being ruled out. At the same time, growth-friendly policies are limited in number and not well targeted. The revised SGP allows countries in surplus to temporarily run deficits, for example to invest more in ALMP. Yet, for economies with record deficits revision of the SGP offers little flexibility. Mr Juncker, presiding over the revision (and the future Mr Euro, presiding over the euro-group), has explained that a 4% deficit is too far from 3% (Bulletin Quotidien 2005). That gives member states limited leeway to stimulate their economies out of recession. It remains to be seen how the revised SGP will be interpreted. There is no consensus on an understanding of 'close to the 3% deficit'.

The revised SGP has not given any attention to the current account balance (see section 1.5). The budget deficit is almost always balanced by savings in the private sector. If recognised, a country with a solid current account position could run up a bigger budget deficit to stimulate investment.

Under all circumstances, it should be borne in mind that competence for fiscal policy remains at national level. However, room for manoeuvre at national level is constrained: national fiscal policy must support the ECB's stability-oriented monetary policies.[8]

3.4 Employment Guidelines

In 1993 unemployment increased in the EU. This created hostility towards the narrow EU objectives of competitiveness and economic stability. The EU had to make job creation a priority.

The Employment Guidelines are a treaty-based instrument. In 1997 the EU inserted an employment chapter in the Amsterdam Treaty. This led to the issuing of the Employment Guidelines, a process which required National Action Plans or NAPs (a reporting procedure in which member states assess how national policies have respected the EU's employment guidelines and recommendations). In 1999 the Employment Pact was agreed. Its main component is the so-called Macroeconomic Dialogue, a forum for the discussion of macroeconomic issues. Participants are the ECB, the EC, the social partners and representatives of member state governments. There is no evidence that the dialogue has had a substantial influence on macroeconomic policy-making (Watt 2005, 237–263).

3.5 The hierarchical pyramid

The ECB is politically and economically independent. It is also independent in terms of goals and instruments (Hein and Truger 2005, 19–67). It laid down the objective of a restrictive macroeconomic policy which is supposed to yield growth. BEPG, which is the heart of economic coordination in the EU, is a supportive monetary instrument of the ECB.

Employment and social policy have the lowest rank in the EU hierarchy. These policies are sub-oriented to BEPG (EG must be consistent with BEPG). Our analysis suggests that full employment is an EU objective with a low status in the hierarchical pyramid, and it

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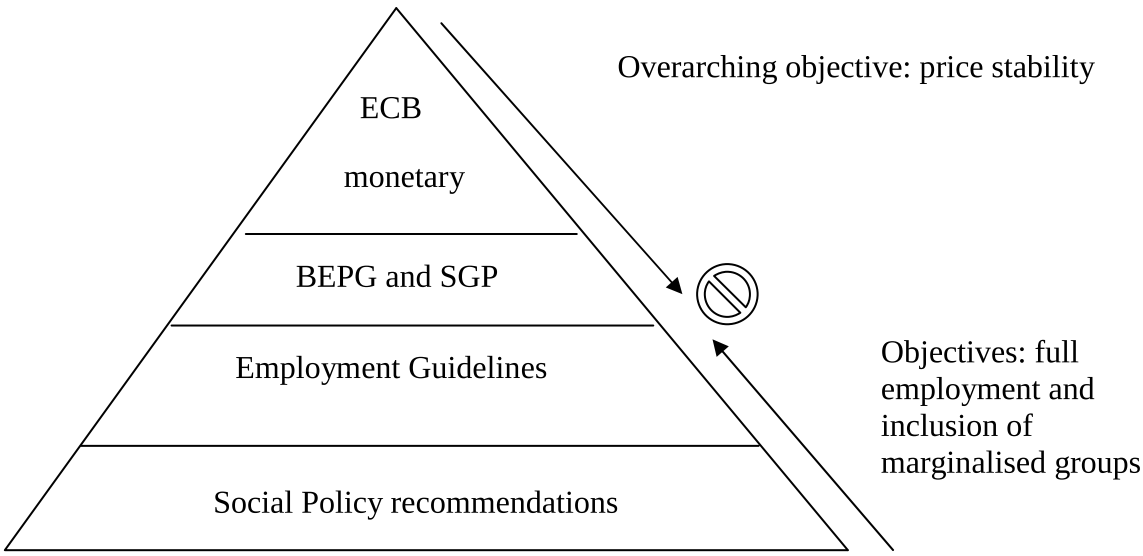
[8] It is academically disputed whether there is a need for fiscal coordination at EU level, or if more fiscal independence at national level would be better (which could compensate for losing the ability to set interest rates according to national economic circumstances).

will remain *unrealised*. Only a policy change in the hierarchical pyramid can make full employment a real option.

Figure 20 illustrates the hierarchy of norms in the EU rules regarding monetary, fiscal, economic, employment and social policies.[9]

Figure 20. The hierarchical pyramid



The monetary instrument of the ECB, adjustment of the interest rate in order to match a self-defined inflation target, is ranked highest. BEPG and SGP[10] are supportive of the ECB objective of price stability. Employment and growth are only secondary objectives in the ECB. The EGs are treaty-based, which is not the case for social policy recommendations (explaining their lower level in the pyramid). Some observers claim that EU governments have voluntarily committed themselves to the hierarchy of rules. However, the situation in which the ECB was created must be remembered: the economy was in an expansionary phase. Germany resisted handing over sovereignty over monetary policy to the EU. It agreed to a common monetary policy only on condition that inflation would be kept under strict control, in a similar manner to the Bundesbank. Ironically, today it is Germany that is suffering most from excessive control of inflation in the eurozone.

There are two possibilities for changing the monetary policy instrument of the ECB: (i) a policy rethink by the ECB, without a new mandate or change in the treaty; or (ii) a change in the treaty. The logic of the hierarchy of rules requires a fundamental policy change at the top level, in the ECB. Therefore, in order to sustain a more employment-friendly institutional setting in the EU, it is indispensable that the ECB change policy.

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9 The Barcelona summit concluded that both employment and social policy should respect BEPG (Casey 2005).

10 It is disputed whether SGP and BEPG are equally legally and politically binding. Although SGP lacks a treaty basis member states have been tried and condemned in the ECJ for not playing by its rules. BEPG is treaty-based but has not been tested. It is noteworthy that BEPG will be reinforced in the EU constitution. If adopted, the Council may issue a warning to member states not respecting BEPG recommendations.

In the present situation, there seems little point in discussing the contents of the EES if other rules may override it. In other words, a desired change in labour market policy will have no effect if the macroeconomic framework limits its implementation. Why do the social partners in the so-called social dialogue therefore support the Lisbon strategy?

We shall briefly discuss the role of the social partners, especially the European trade unions, which strongly criticise the hierarchy of rules yet remain committed to them. This will be followed by a set of recommendations for reform.

3.6 The social dialogue

The social dialogue became an active process with the Single European Act of 1985. It is now an established instrument for developing social policy. The EU considers this to be a cornerstone of the European social model:

> The European social dialogue is a unique and indispensable component of the European social model, with a clearly defined basis in the EC Treaty. It refers to the discussions, consultations, negotiations and joint actions undertaken by the social partner organizations representing the two sides of industry (management and labour). (Social Dialogue, DG Employment 2005)

The social partners have several roles to play: (i) they have the autonomy to negotiate agreements between themselves which could be translated into EU directives or transposed into national level for implementation (laws and/or collective agreements); (ii) they have agreed to a multiannual working programme supporting the Lisbon objectives; furthermore (iii) the social partners are actively influencing the EES and the EU Commission's drafting of the Employment Guidelines (Benchmarking Working Europe 2005).

In the most recent Social Agenda 2006–2010 the EU Commission proposes that the social partners engage in transnational collective bargaining. In addition, the new inter-generational approach is at the heart of the social agenda. The EU Commission proposes a strategy of active aging, encompassing lifelong learning, improvement of the working environment and flexible transitions between employment and retirement (speech by Commissioner Spidla 2005). In other documents the EU Commission stresses the need to reinforce the partnership between the EU and the social partners (EC: COM 2004:557). The role of the social partners in implementing the Lisbon strategy has been reinforced.

At first glance, it may appear entirely positive that workers' representatives have a say in EU policy-making. However, the role of the social partners is ambiguous. Year after year the ETUC reiterates its support for the Lisbon strategy. At the same time, it fiercely opposes the deregulation agenda which underlies most of the relevant reforms. One example is a press statement on the proposed BEPG: 'ETUC seeks major overhaul of draft Broad Economic Policy Guidelines' of 13 May 2005. It criticises the EU for 'once again' concentrating on structural reforms. It should be born in mind that BEPG is the central economic policy document at EU level, trumping the Employment Guidelines.[11] That leads to two problems for the trade union movement. First, the ETUC could be used as a

[11] In 1997 the ETUC accepted that BEPG would become the main instrument for growth and employment (Casey 2005).

cover for the EU to push through deregulation of labour markets. The argument is that if the ETUC, which defends 'social Europe', supported the Lisbon agenda, workers would tend to assume that their interests were being properly protected. However, BEPG has remained beyond the reach of the social partners (Casey 2005). The structural reforms have been on the agenda since 1993, almost unchanged from year to year.

The second problem is that the EU would like to provide the ETUC with more resources (financing) for implementing the Lisbon agenda. However, as long as the pre-established rules at EU level mostly concern structural reforms and so are unfavourable to the trade unions this would appear to be rather ill-advised. Recalling the hierarchical pyramid presented above – in which the ECB and BEPG totally dominate EG and social policy – is it possible for the ETUC to continue to support BEPG as a policy instrument? The structural reforms are based on the assumption that the unemployed are unwilling to take up jobs (on this basis, sanctioning of the unemployed is the best policy).

On the other hand, it can be argued that the ETUC has taken a pragmatic approach which could prove to be successful in the long run. In the EU, decisions are always a result of compromises. The first step is to institutionalise a role in the EU structure. The social dialogue has created such a platform for the trade unions. As a result, the ETUC has gained an influence in EU decision-making and agenda setting. The alternative – a more confrontational approach to EU policy – risks exclusion from any influence at all.

There are positive experiences at national level to draw on. In countries in which there have been social pacts – including central wage bargaining – it has been possible to combine full employment and low inflation, based on the assumption that the unemployed are willing to take a job. This is shown by the Scandinavian countries. Clearly, a debate should be launched on the coordinating role of the ETUC in this regard, assembling information on national wage coordination systems, while fully respecting national collective bargaining traditions.[12]

Having said that, it should be noted that the social dialogue is currently in a logjam, and the outlook for new initiatives in the coming years is limited. The social partners are experiencing a climate of conflict and the dialogue lacks momentum. The employers' representative, UNICE, is refusing to expand the framework of the social dialogue. In its opinion, the sole purpose of the dialogue should be to promote economic and social change via a non-binding and flexible approach (Degryse 2005).

3.7 Policy recommendations

Put the ECB under democratic control.

Establish a management board for the ECB consisting of finance ministers and social partner representatives. To improve transparency, the minutes of board meetings should be accessible to the public, in contrast to the current secrecy. This would serve as a catalyst to achieve a twofold purpose: policy change (see section 4.4) and accountability.

[12] The ETUC supports wage settlements based on productivity growth and consumer price inflation (Hein and Truger 2005).

The mandates of BEPG and EG constitute a striking example of the inconsistency of policy goals, as indicated by the hierarchical pyramid. Arguably, full employment is the main political objective of the EU.

Set BEPG and EG on an equal legal footing and clarify their respective roles.

Recognise EG as a policy instrument in their own right. They are recognised de jure, but suffer from the dominance of BEPG. EG should be the main tool for addressing all labour-market and employment challenges, including microeconomic challenges and macro-economic wage coordination policy (there is more on economic and employment policy recommendations in sections 4 and 5).

4. Economic reforms

4.1 The ECB must begin to support job creation

Unemployment has an effect on real wages.[13] The army of unemployed in the EU means that workers have to accept lower real wage increases than would be the case with an economy operating at its potential. Is there a systematic macroeconomic[14] strategy to use the millions of unemployed as a buffer to keep down wages?

There is a less elegant [than the neoclassical version] but more convincing story to be told about the declining economic well-being of the less skilled in the developed world, a story in which low-skilled workers have borne the brunt of weak aggregate demand, massive economic and demographic shifts, and, of course, labour market deregulation. (Howell 2005, 339)

4.1.1 Wind of change?

There are signs of a wind of change among monetary hawks. The OECD, considered by most observers as a bastion of orthodox economic policy, are reiterating the policy stance of the European trade unions: there is a compelling case for the ECB, 'by significantly cutting interest rates' (OECD May 2005), to generate investment and push up demand for labour. A Financial Times leader provides an even more straightforward message:

Non-Europeans are frequently baffled by the apparent dogmatism of European Monetary Policy. Under the Maastricht Treaty, the ECB is committed to maintaining price stability. The extent to which the central bank is obliged to focus on this at the expense of other goals is extreme, as is the degree of its independence. (FT, 25 May 2005)

4.2 Stimulating the economy

In the present situation in Europe, for instance, with low demand for credit and extremely low levels of investment, it is difficult to imagine that a cut in the ECB interest rate would result in accelerated inflation. As already noted, the ECB is not even considering the impact of underutilisation of capacity or low domestic demand. Its only concern is to remove wage rigidities and so urges more structural reforms as the single most important measure for inducing growth.

Of course, Keynesianism has its limits in an open world economy. As a result of capital market liberalisation stimulation from an interest-rate cut may be less effective. If investors prefer Asia to the EU – or any other destination – for reasons unrelated to interest rates, an interest cut will make no difference. Clearly, investments are only partially decided by interest rates.

In Keynesian economics, which we embrace in this paper, investments are important for employment creation for several reasons. Capital investment not only benefits the enterprise doing the investing, but has a multiplier effect on the rest of the economy.

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[13] This has been neglected by Keynesians (Stockhammer 2004).

[14] Macroeconomic refers to the overall, aggregate European level, microeconomic to the entrepreneurial and individual worker/consumer level.

Increasing productive capacity affects also the supply side and thus economic growth. Investments not only build additional capital and supply, but are also a component of aggregate demand itself. Ensuring that productive capacity is fully utilised would restore investment incentives. This would pave the way for a virtuous investment circle which will allow the economy to grow faster without fear of overheating. In addition, matching between demand and supply in the labour market will be improved. The newly employed will receive more training, while those still unemployed will become more active in taking up training and in job seeking. Lower interest rates could also have a positive impact on innovation. An annual investment cycle of 7–8% could take the EU economy to its potential growth rate, from its current 2% to 3% (ETUC note, macroeconomic conference, March 2005).

This paper argues, therefore, that under certain given conditions a non-inflationary growth cycle could be triggered and sustained by a cut in the ECB interest rate. The assumption is that the economy is underperforming: actual output is below potential output. The initial objective is to set the economy on its potential growth path and subsequently to raise the potential growth rate. This would occur by means of induced investment, productivity and labour market effects (EEB PB 1/2005). The macroeconomic dialogue and reinforced social pacts nationally could contribute to wage formation within the limits of a new, more flexible inflation target (see section 4.4).

4.3 Drivers of growth

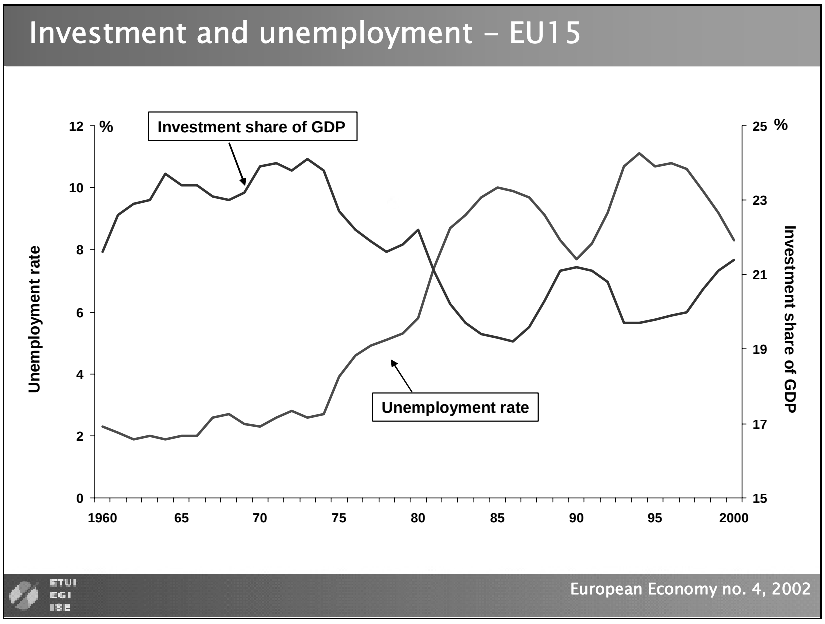
There is compelling evidence that dynamic investment is important for productivity growth and employment. In our view, supported by empirical evidence, there are three main determinants of long-run growth in high-income countries: (i) research and innovation, (ii) human capital and (iii) the speed at which new technologies are diffused. Thus, growth is inhibited by anything that reduces either investment or skill acquisition. For medium-income countries physical investments are the main driver of growth.

This paper proposes two ways of investing in these growth drivers. (i) Fiscal spending: more investment in R&D is crucial. (ii) Monetary policy: a cut in the ECB rate as an economic tool to support and trigger growth. Demand is the main driver of growth. It may be necessary to add that a sound fiscal policy on the part of member states remains vital. Structural deficits are neither part of a Keynesian programme nor desirable in general (Stockhammer 2004). If considerable fiscal imbalances drive up interest rates, this may crowd out investments in the business cycle. That would be unhelpful to the unemployed.

Examples of dynamic investments are R&D, a substantial percentage of the population in higher education, ICT expenditure and a high proportion of ‘progressive’ industries. Is there a relationship between investment and unemployment?

Figure 21 suggests a clear connection between investment as a share of GDP and unemployment. It is remarkably stable over time (since the early 1960s). Figure 21 indicates that when the investment share of GDP increases, there is a corresponding reduction in the unemployment rate. A recent study shows that a combined investment strategy at national and EU level could make the EU grow more rapidly and add up to 4 million new jobs by 2010 (AE Rådet 2005).

Figure 21. Investment and unemployment in the EU-15



Based on our findings, we will now turn to more precise policy recommendations for the macro level of the economy. Their aim is to establish a policy mix supporting a non-inflationary sustainable growth path which can bridge the gap between actual and potential growth. We want the EU economy to work faster and harder in order to bring down high unemployment.

4.4 Macroeconomic policy recommendations

The price stability objective of the ECB – below but close to 2% – is too rigid. The eurozone is a heterogeneous monetary area, as shown by the various levels of productivity in different countries. This signifies different industrial bases, various welfare systems and diverging levels of investment. In brief, the eurozone members are not economically convergent (Conway et al. 2005). This calls for greater room to manoeuvre on the part of the ECB, so as to avoid sliding into an interest rate close to 0% and deflation. That risk will increase if the ECB continues to wait to cut the interest rate, since the gap between actual and potential growth is widening.

The price stability target of 2% would benefit from a more flexible approach, giving scope for deviations

As shown by our assessment, the ECB is not exploiting the growth potential of the EU economy. For most of the ECB's existence the EU has functioned below its potential growth. This is unwise from an economic perspective and unacceptable from the workers' point of view. Therefore, the ECB should give some leeway to economic and employment growth. This would enable it to cut interest rates when there is no obvious risk of inflation (Begg 2004).

There is an urgent need for reform of the ECB monetary objective: it should support price stability and maximise growth and employment (which is the present mandate of the US Federal Reserve)

The imbalance in the world economy (US as consumer of last resort, EU and Asian economies very export oriented) is alarming. EU consumers are piling up huge savings and long-term interest rates are at historic lows. Action is needed to use the excess savings in Europe to meet the Lisbon objectives (instead of these excess savings fuelling the already worrying US real estate bubble).

The European Investment Bank should issue a 'European Growth and Lisbon Bond'. This could ensure the long-term financing of the Lisbon priorities (approved at the ETUC executive meeting, 19–20 October 2005)

As shown in section 2.5, paying attention to the deficits alone, and neglecting the savings of private firms and consumers, makes the SGP a one-sided economic instrument. It would be better to focus on the current account balance. As long as it is in surplus, the economy as a whole is not performing as badly as the revised Stability and Growth Pact's narrower approach might have us believe.

Loosen up the SGP to allow for more growth friendly investments (using the current account balance as measure, replacing the one-sided focus on budget deficits) (see ETUI-REHS 2005b for more reform suggestions)

Strictly speaking, wage determination remains within the competence of the social partners at national level. However, as early as 2000 the Council stressed that with EMU the link between wages and employment would become more evident and stringent (Marginson and Sisson 2002).

Open a debate on how to avoid excessive inflation in the whole EU area, and the role of the ETUC in this matter

To some extent, a better coordinated debate on wages at EU level would avoid 'beggar-my-neighbour' problems (promoting one's own interests at the expense of others). The competition for lower wages in the EU is not in the interest of workers. A practical example from Morley et al. (2004) considers that wage levels should be related to the medium-term productivity trend in each country.

Empower the social partners to play a role in reformulating or reinventing 'structural reforms'. It should aim to reconcile the increasing distance between the growing corporate wealth in the EU and the protection of those who produce it. This entails more concern for unemployment due to restructuring. Trickle-down policies must be replaced with investment strategies. It is time to open a debate on the question of whether structural reforms are ends or means. They should be the latter and contribute to the Lisbon objectives. Evidence that BEPG has produced productivity growth is at best tentative.

Rethink structural reforms

Adaptation to the so-called knowledge-based society is burdensome for workers. The EU is calling on them to become more employable: always ready to adapt to changing economic circumstances. The least (but not the only thing) society can do in return is to provide lifelong learning for all social groups. Studies show that the less skilled receive less training than the higher skilled (Benchmarking Working Europe 2005). The less skilled risk becoming long-term unemployed, which in essence means they are becoming less employable in the eyes of employers. Therefore, marginalised groups should be adequately prioritised in order to raise the level and quality of employment.

Inject life into a proactive New Growth Initiative investing 3% of GDP in Lisbon priorities (research, education and training, active labour market policies, social housing, green technology, and so on) (A recommendation reiterating the resolution of the ETUC executive committee of 14–15 June 2005)

Nothing has so far been mentioned about environmental sustainability. The reason for this is that there is no direct link between that and more and better jobs, our main focus. However, good management of natural resources (air, water, and so on) is a prerequisite of people's well-being, especially future generations. It is also one of the pillars of the Lisbon Strategy. In 2002, the EU integrated the concept of 'decoupling': this means that we must achieve higher growth without increased use of resources (Larsson 2005). The following recommendation is in line with the Johannesburg declaration for sustainable development, which is the platform for EU policy on the environment. It concludes that sustainable consumption and production should promote social and economic development, de-linking economic growth and environmental degradation by improving efficiency and sustainability in the use of resources and production processes and reducing resource degradation, pollution and waste (Johannesburg declaration 2002).

Combine innovation policy with the development of environment-friendly technology (eco-efficiency as a competitive advantage)

5. Revitalising EU labour markets and social policy

One lesson emerging from our analysis is that more flexibility on the labour market without increased security equals insecurity. This has a number of negative consequences for the functioning of the labour market. Workers become reluctant to change and desire to maintain the status quo. If they fear having to take worse jobs or accept lower wages due to the closure of old industries, the result could easily be protectionism. The fear of change for the worse takes the form of higher savings and declining confidence in the economy. All this has adverse repercussions on the economy as a whole. It is therefore problematic that structural reforms seem to be reinforcing this vicious circle.

What can turn a vicious circle into a virtuous one? Denmark, for example, seems to have successfully combined flexibility and security in what has come to be known as ‘flexicurity’. The Danish model is a good recipe for the management of fear and provides a model of how to make people both ready and willing to face change. This section will deal with job quality and the need for more social services if we are to raise employment levels in the EU.

5.1 Danish flexicurity

The Danish experience of flexicurity – which aims to combine a *flexible* labour market for companies with a degree of *security* for workers – has successfully complemented stick (social disciplining) and carrots (social integration). One trigger of the new flexicurity model was a giant leap towards an expansive fiscal policy (Larsson 2005). The Danish model’s major achievement is that it has managed to take both supply and demand into account.

The Danish model[15] is fundamentally a new social contract with both duties and obligations, on the part of both society and the individual. In the 1994 reform jobseekers were not considered potential ‘free-riders’. The assumption that in general people are willing to find a job is predominant. Irrevocable rights (access to services) should be matched with duties (participation in labour market activation programmes).

The model is characterised by low employment protection, but relatively high benefit and benefit-duration levels give individuals a certain autonomy. Personalised plans for each unemployed person are required at local level. Employers’ organisations, trade unions, the state (AF) and local authorities are involved in the joint project of finding work for jobseekers. However, whether the significant policy shift towards individualisation in the management of social risks (restructuring and unemployment) is sufficiently shared by the welfare state is an open question. According to Per Kongshøj Madsen, 26% of persons of active working age are excluded from the labour market and covered by different transfer systems (ETUI-REHS workshop, 13 June 2005), including retirement pensions (*efterløn*) and disability pensions.

Returning once more to the discussion on ALMP in the UK and Denmark, it is possible to use different policy mixes and to achieve high employment levels. But are they equally

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15 Much Danish success is built not only on policy design, but also on its effective implementation (Larsson 2005).

good for the workers? One hypothesis is that people respond to both sticks and carrots, in varying degrees, depending on the availability of welfare. But surely job satisfaction (quality) will be different depending on whether sanctions compel people to take any job (occasionally below their skills), or benefit levels and durations allow them to either upgrade their skills and get a better job, or have a better chance of getting a job which matches their skills.

Figure 22. Job quality, average tenure and employment security

Ranks in:	Quality 1=highest	Tenure 1=lowest	Security 1=highest
Norway	n.a.	4*	1
Denmark	1	3	2
Ireland	8	10	3
Netherlands	3	5	4
Finland	2	8	5
Belgium	6	14	6
Austria	5	9	7
Italy	10	15	8
Germany	4	6	9
Sweden	n.a.	12	10
France	n.a.	11	11
United Kingdom	7	2	12
Greece	12	17	13
United States	n.a.	1	14
Portugal	11	16	15
Spain	9	6	16
Japan	n.a.	13	17

Quality : Ranking of share of good jobs in a country : good jobs are defined as paying good wages, giving job security, good access to training and good career prospects (EU Commission, *Employment in Europe 2001*)
Tenure: Ranking of average tenure in years (ILO 2003, see above)
Security: Ranking of combined indicators of people worried or unsure about their job (*International Survey research*, OECD)
n.a. = not available.

Source: Auer (2005).

Figure 22 supports the hypothesis that Denmark does significantly better than the UK at offering the unemployed career prospects, decent wages and a feeling of job security.

In conclusion, as shown by the ILO figures, it is possible to have both flexibility and security. In fact, the quality variable in the index – good wages and good training possibilities – further adds to security. A good policy mix for Europe would combine flexibility and security in a balanced way.

5.2 Job quality

There is no accepted definition of 'job quality' in the EU. The concept has a number of dimensions. Two are emphasised in the EU's understanding of quality: job characteristics and the work and wider labour market context (European Commission 2001).

Job characteristics include: job satisfaction, remuneration, non-wage benefits, working time, skills and training, prospects for career advancement, job content, match between job characteristics and worker characteristics.

The work and wider labour market context includes: gender equality, health and safety, flexibility and security, access to jobs, work/life balance, social dialogue and worker involvement, diversity and non-discrimination.

How can jobs be made more attractive to workers? This question is closely related to the issue of the reconciliation of work and family/private life. There are differences between the old and new member states in terms of the balance between paid work and household work. In 2003 a survey on working conditions was conducted in the new member states, comparing them to the results of earlier surveys of the EU-15 (earlier surveys from 2000).

The survey suggests that work organisation in the new member states is more traditional and industrial, and less service oriented. More concretely, work is more hierarchical than in the EU-15. Concepts such as quality control and work autonomy are rather new. Consequently, there is less worker responsibility for production planning. Training is offered to 65% of employees, in contrast to 72% in the EU-15. Job control – meaning control over either work organisation or working hours – is considerably lower in the new member states.

Turning to income, there are more lower wage earners in the new member states (24% compared to 22%), but the gender gap is, surprisingly, less prominent. This is due to the higher number of women on high incomes and the lower proportion in the lower income bracket, as well as fewer part-time workers. Working time is much higher – 44.4 hours a week – in the new member states, compared to 38.2 hours on average in the EU-15. Finally, the survey on dual workloads reveals some intriguing facts, seemingly contradicting prejudices about the patriarchal character of Eastern Europe societies. The proportion of women in work is higher in the new member states than in the EU-15. As a result, men in the new member states would appear to share caring for and educating children, cooking and other housework significantly more than their counterparts in the EU-15. Part-time work, often performed by women, is less common in the new member states (7% compared with 17% in the EU-15). Less part-time work thus seems to have a positive impact on sharing the burden of family life between men and women.

In brief, in the EU most people esteem having a job as the single most important criterion of a good life. However, this does not mean that they are indifferent about working conditions. Poor quality work with stress or other negative health characteristics has a negative effect on quality of life and less health satisfaction. In short, the pursuit of more and better jobs must at all costs avoid becoming a blueprint for more working poor.

Conclusion

In the run up to the mid-term evaluation of the Lisbon strategy this year, the Barrosso Commission threatened to downplay the social pillar. It disputed the starting point of the Lisbon strategy according to which social reform and economic reform are mutually supportive. In contrast, the EU Commission argued that first we must introduce economic reform, and then, as a consequence of increased growth, we can afford social reform. If this is true, why do the Nordic countries always score highest on the Lisbon benchmarks?

In fact, since the start of the Lisbon process in 2000, the Nordic countries, famous for their relatively generous social welfare systems, have clearly outperformed the eurozone. By all measures, be it employment rates, unemployment rates, productivity growth and/or other more sophisticated welfare comparisons, the Nordic countries come top. They have high growth and high productivity *and* spend most on social issues and have a tradition of strong labour market institutions. In contrast, the eurozone has experienced sluggish economic growth. Thus, strong social cohesion does not seem to be an obstacle to growth and job creation.

We have also tried to document the risks of prescribing pure labour market flexibility without providing compensation in terms of increased security for workers. A one-sided policy in favour of more flexibility, which is the core message of BEPG, is counter-productive. Workers become reluctant to change and want to maintain the status quo. If they fear changes for the worse, this is likely to lead to higher precautionary savings. That seems to lead to declining confidence in the economy. And firms, in turn, are reluctant to invest, since domestic demand weakens and they are not sure of selling their products.

What can turn this vicious circle into a virtuous one? The Danish model constitutes a good recipe for the management of fear and for making people both ready and willing to face changes. The model consists of low employment protection combined with relatively high benefit and benefit-duration levels which give individuals some autonomy. Efficient ALMP is part of the explanation. In addition, employers' organisations, trade unions and local authorities are jointly involved in the task of finding work for jobseekers. In conclusion, to prevent further economic slowdown, the balance of the original Lisbon strategy must be re-established. Social reforms must go together with economic reforms.

Besides these important reforms, there is an urgent need for reform of EU macroeconomic policy. As we have shown, the engine of the economy – domestic consumption – is weak. And if there is no job creation, no matter how efficient ALMP, the unemployed will not find a job. What is needed is macroeconomic policy which stimulates demand and the creation of new jobs. Both monetary and fiscal stimuli are urgently needed in some eurozone member states. This would break the vicious circle and people would start to consume more of their income, allowing companies to invest more.

We suggest that the ECB should start to take responsibility for employment. However, making full employment an objective to be taken seriously requires reform of the ECB. There are two alternatives for change: either internal reform – for example, making the inflation target much more flexible – or a change in the Maastricht treaty. Either option would make the inflation target considerably more flexible. Under the current economic circumstances, a cut in the ECB rate would expand output and more jobs would be created. These benefits would outweigh a possible limited rise in inflation.

In addition, it would be economically sound for countries with high deficits *and* falling domestic demand to actively ignore the SGP spending ceiling. Otherwise, they risk finding themselves in an even worse situation, characterised by deflation. Germany is especially ill-suited to follow the rules of the SGP.

In conclusion, against the background of our empirical findings, the EU requires modernisation of its monetary and fiscal policies, if it is to arrive at full employment. It is time to recall Keynes's saying: 'When the facts change I change my mind.' It is about time the EU changed its mind!

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Integrated guidlines for growth and jobs 2005-2008

(guidelines 1-16 previously called the Broad Economic Policy Guidelines, guidelines 17-24 previosly called the Employment Guidelines)

1. Guarantee the economic stability for sustainable growth.

2. Safeguard economic and budgetary sustainability, a prerequisite for more jobs.

3. Promote an efficient allocation of resources, which is geared to growth and jobs.

4. Ensure that the development of salaries contributes to macroeconomic stability and growth.

5. Strengthen the consistency of macroeconomic, structural and employment policies.

6. Contribute to the dynamism and smooth operation of the EMU.

7. Increase and improve investments in research and development, in particular in the private sector, with a view to establishing a European area of knowledge.

8. Facilitate all forms of innovation.

9. Facilitate the spread and effective use of ICTs and build a fully inclusive information society.

10. Strengthen the competitive advantages of its industrial base.

11. Encourage the sustainable use of resources and strengthen the synergies between environmental protection and growth.

12. Extend and deepen the internal market.

13. Ensure open and competitive markets inside and outside Europe, reap the rewards of globalisation.

14. Create a more competitive business environment and encourage private initiative by improving regulations.

15. Promote a more entrepreneurial culture and create a supportive environment for SMEs.

16. Expand, improve and connect European infrastructures and complete priority cross-border projects.

17. Implement policies aiming at full employment, improving quality and productivity at work, strengthening social and territorial cohesion.

18. Promote a lifecycle approach to work.

19. Ensure inclusive labour markets, enhance work attractiveness, and make work pay for job seekers, including disadvantaged people and the inactive.

20. Improve matching of labour market needs.

21. Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of the social partners.

22. Ensure employment friendly labour-cost development and wage setting mechanisms.

23. Expand and improve investment in human capital.

24. Adapt education and training systems in response to new skill requirements.