

Decent work and competitiveness: Labour dimensions of accession to the European Union

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Enlargement of the European Union (EU) from its current 15 Member States to 25 or more represents a significant development for the EU and for the candidate countries. The success of enlargement rests on whether it will lead to sustained increases in living standards in the 13 candidate countries.¹ For this, full employment in conditions of decent work must become a central objective of policy in candidate countries and in negotiations with the EU. Economic, social, trade and labour market policies should converge into a coherent set of policies combining full employment, social protection, basic labour standards and social dialogue to sustain the foundations of enlargement of and accession to the EU. Employers' and workers' organizations should play an active role at various levels in order to support the convergence on decent work.

Accession to the EU provides an opportunity for accelerated economic growth and rising real incomes through structural adjustment and reform, a process of real convergence with EU income and welfare levels. At the same time, candidate countries are expected to enter into what is termed "nominal convergence", or sustained non-inflationary growth conforming with the criteria laid down in the Maastricht Treaty, enabling them eventually to join the European Monetary Union (EMU). The implications of real and of nominal convergence differ for employment and for social welfare, and the extent to which they are compatible is not clear. For both economic and social reasons, employment, labour productivity and social welfare are critical dimensions of

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¹ These are Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia and Turkey. Turkey has not yet opened formal negotiations on accession. Bulgaria and Romania are expected to conclude negotiations later, in order to formally join the EU by 2007.

the convergence process.² In particular, competitiveness in candidate countries is directly dependent on sustained increases in labour productivity. Rising levels of labour productivity require a set of policies that promote stability, cooperation and training, rather than insecurity and low wages. Policies that combine rights at work, employment, social protection and social dialogue, that is, policies for decent work, stand a better chance of promoting an environment conducive to sustained rises in labour productivity.

This article will examine first the employment and labour dimensions of real and nominal convergence, using data for 1995-2000; it will then discuss the labour market policies required to combine real and nominal convergence successfully.

Background to enlargement of the EU

The EU is committed to broadening its membership (currently 15 countries). A number of countries are negotiating to become members of the Union in the next few years. The principles and conditions of membership of the EU were defined at the European Council held in Copenhagen (1993), and elaborated at subsequent European Councils (at Nice in 2000, Göteborg in 2001, and Copenhagen in 2002).³ Future members are required to establish their capacity to assume the full responsibility associated with membership, including adherence to the aims of political, economic and monetary union. Candidate countries are required to harmonize their internal laws and regulations with those of the EU in all the areas covered by the Treaty on European Union.

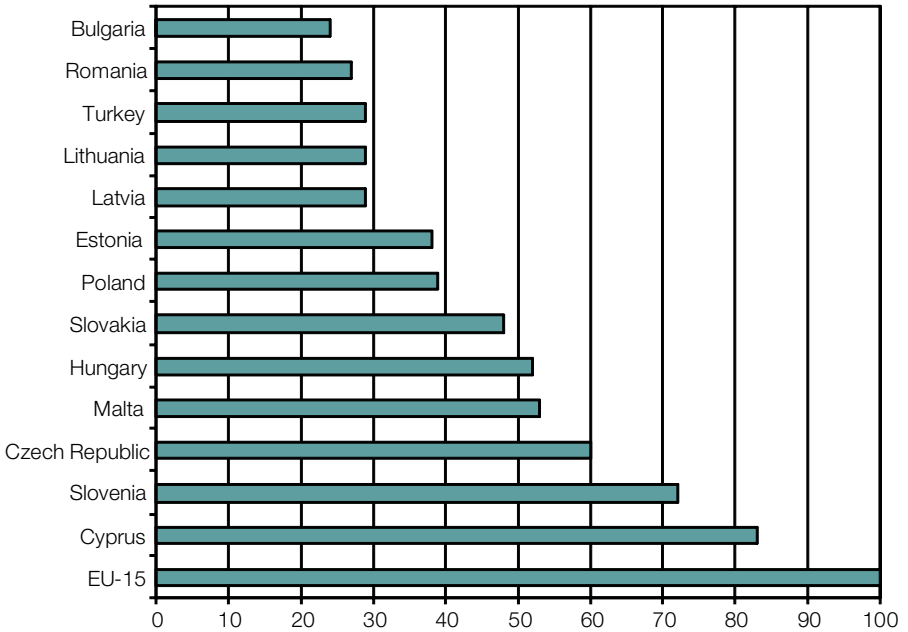
Beyond adherence to the political aims of the EU, accession is a means for candidate countries to converge with EU income levels and standards of living. Average (weighted) per capita income in 2000 in the 13 countries was 34.9 per cent of the EU-15 level, with significant disparities between the candidate countries (figure 1), ranging from Bulgaria (under 30 per cent) to Slovenia and Cyprus (over 70 per cent).⁴ The demographic weight of the 13 candidate countries far outstrips their economic importance. The combined GDP of the candidate countries represented 15.5 per cent of the EU-15 GDP in 2000, but their

² Similar issues with regard to EU labour markets are discussed in Peters (1995) and Raines (2000). An early assessment of central and east European labour markets in the context of enlargement is given in Burda (1998).

³ The European Council of Copenhagen (2002) noted the successful conclusion of accession negotiations for ten candidate countries that stand ready to join the EU in May 2004.

⁴ This income gap is much larger than for previous enlargements of the EU. When Greece (1981), Spain and Portugal (1986) joined the EU, their GDP per capita levels amounted on average to 65.6 per cent of the respective EU average.

Figure 1. GDP per capita, 2000 (purchasing power parity) (EU-15 = 100)



Source: EUROSTAT (2002), p. 5.

total labour force was equivalent to 47.9 per cent of the EU-15 labour force (30.1 per cent without Turkey).

Membership can bring clear advantages in terms of a more stable institutional environment, reduced transaction costs and greater trade linkages. This may then foster an environment conducive to investment, in particular to foreign investment, and contribute to faster economic growth as well as social development, enabling these countries to raise living standards rapidly and converge towards EU-15 levels thereof. Employment levels, working conditions and social protection stand to gain from rapid convergence.

At the same time, significant potential problems should not be underestimated. Membership of the EU implies joining a trade and economic union. In principle, there should be free movement of goods, services, capital and persons. In practice, however, discussions on the free movement of workers are on-going. In addition, transition periods of varying duration are being considered for different products in which candidate countries have a clear comparative advantage (for instance, in agriculture or steel). Important negotiations are under way in these areas, the implications of which for employment and welfare should not be underestimated.

Candidate countries are required to incorporate into their respective national legislations the EU legislation (*acquis communautaire*) which covers the full span of economic, social, environmental and legal regulations. Such legislation includes the fundamental principles and rights at work defined by the ILO, as well as many other areas covered by ILO labour standards.

Membership of the EU does not automatically imply membership of the EMU. Candidate countries are expected to follow the same procedure that led to the formation of the EMU and, hence, to have complied with the Maastricht criteria for some time. Notably, a candidate country must be able to sustain a high degree of nominal convergence with the standards of the Euro area, in particular as regards price stability. A first step is for countries to join the exchange rate mechanism (ERM-2), whereby the European Central Bank and the relevant national central bank jointly adjust rates within a band of fluctuation of ± 15 per cent. A candidate country is expected to have remained within the ERM-2 for at least two years prior to joining the EMU. Various exchange rate arrangements are compatible with the ERM-2.

Employment and labour implications of real convergence

One of the defining characteristics of an economic and monetary union is strengthened trade linkages, which are both an engine and a consequence of integration. Already, over half of candidate countries' exports go to the EU (51.7 per cent on average in 2000, with a low of 33.5 per cent for Malta and a high of 76.5 per cent for Estonia), and 55.5 per cent of their imports come from the EU (European Commission, 2001). Closer trade integration has accelerated as a result of the structural change undergone by many of these countries since 1989, notably the liberalization of trade and capital. Negotiations over accession to the EU have no doubt further accelerated such trends: first, by reducing the estimated risk to future investment as a result of possible entry into the EU; and second, by enhancing the attractiveness of greater trade integration. In particular, geographical proximity to the EU market, lower relative labour costs, and a well-educated labour force have been and remain strong incentives for foreign direct investment.

Labour cost differentials

One reason for closer trade integration between candidate countries and the EU is differences in relative factor endowments as seen, for instance, in the relative labour costs of the EU and the candidate countries. ILO data suggest that in the late 1990s those countries' manufacturing labour costs were on average less than 10 per cent of the highest

Table 1. Labour costs in manufacturing (US\$ per hour)

Country	1995	1996	1997	1998	1999	2000
Czech Republic	2.96	3.33	3.16	3.44	3.40	...
Estonia	2.00	2.38	...	...	...	...
Germany	35.27	34.75	30.79	30.96	26.68	32.00
Hungary	3.77	3.60	3.42	3.46	3.49	3.38
Latvia	...	...	2.01	...	...	...
Lithuania	...	1.63	...	...	...	...
Poland	...	2.86	2.95	3.21	3.22	...
Romania	1.21	1.25	1.06	1.30	1.16	...
Slovakia	...	2.80	2.85	3.17	2.76	...
Slovenia	6.77	6.77	6.43	6.83	...	...
Turkey	2.99	2.94	...	...	...	...

Note: Nominal labour cost expressed in US\$ using average annual exchange rate as published in IMF (2001).

Sources: ILO (2001), table 6A; IMF (2001), country tables.

labour cost country of the EU (Germany), with a range from 4 to 22 per cent in 1998 (table 1).⁵ The hourly compensation cost in manufacturing for the EU calculated by the Bureau of Labor Statistics of the United States Department of Labor averaged US\$20.17 in 1999 and US\$18.33 in 2000 (BLS, 2001).

It is likely that labour cost differences will gradually narrow as a result of greater trade integration. Between 1995 and 2000, real wages (total economy) in eight out of ten countries for which data are available increased at an average rate of 3.9 per cent per year (table 2).⁶ As a result of closer trade integration with the EU, the pace of real wage increase is likely to remain sustained, for a variety of reasons. One should bear in mind the very low initial level of wages, that fell further in many countries in 1990-94. It is impossible to say how long labour cost convergence will take, save to observe that substantial differences continue to prevail between countries of the current EU-15, in spite of over 20 years of close integration.⁷

⁵ The data presented here use 1995 as the base year. From 1995 onwards, most candidate countries entered a period of relative macroeconomic stability that facilitates comparison between countries. However, a proper evaluation of trends in each country would need the comparison of the situation today with that prevailing in 1989 or 1990. In particular, few countries have recovered 1989 levels of employment, wages or GDP. Owing to data limitations, not all 13 accession countries are systematically included in the tables produced here.

⁶ The collaboration of the United Nations Economic Commission for Europe (UNECE) in making available some of the data presented here is gratefully acknowledged.

⁷ By way of illustration, the hourly compensation cost in 2000 was US\$4.75 in Portugal, US\$12.5 in Ireland and US\$21.11 in Belgium (BLS, 2001).

Table 2. Trends in real wages in total economy (1995 = 100)

Country	1996	1997	1998	1999	2000	2001
Bulgaria	81.10	72.10	79.44	86.69	90.47	94.36
Czech Republic	108.09	111.99	111.50	116.47	120.06	121.82
Estonia	101.66	109.43	113.47	121.30	129.06	...
Hungary	96.21	102.68	104.03	102.51	103.90	110.76
Latvia	95.42	101.44	109.15	116.77	122.41	...
Lithuania	105.30	117.65	138.18	146.00	146.38	141.28
Poland	105.88	112.95	118.94	122.12	124.93	126.80
Romania	107.59	83.47	88.39	87.71	84.15	87.93
Slovakia	108.14	111.35	114.58	111.87	108.98	111.40
Slovenia	104.50	107.38	108.86	112.01	113.43	116.75

Source: UNECE database and author's calculations.

Labour productivity

In terms of labour productivity, the performance of most candidate countries has been remarkable, particularly since 1995. Table 3 presents indices of labour productivity for ten countries for the period 1995-2001. By 2000, labour productivity had increased on average by 33.3 per cent (an average annual increase of 5.9 per cent). Estonia, Hungary, Latvia, Poland and Slovakia performed particularly well. In terms of labour productivity levels or value added per person employed (in manufacturing), it is noteworthy that in 1998 candidate countries had reached levels ranging from 28 to 82 per cent of the EU-15 average, mainly but not only in foreign-investment enterprises (UNECE, 2001). In general, the average annual growth in labour productivity in the sample countries significantly exceeded the EU average. This clearly points to a process of catching up, in which foreign investment played a significant role as catalyst for the transfer of new technology, production techniques and managerial know-how.

A large part of the growth in labour productivity can be attributed to adjustment and restructuring, as enterprises gradually adapted to the modern organization of production and technology. Countries have therefore experienced both rising levels of labour productivity and declining employment in manufacturing. Clearly, the challenge ahead is to sustain high growth in output per person, whilst simultaneously maintaining or even increasing employment levels. The sectoral distribution of employment is an important issue here. Table 4 provides information on the percentage change in manufacturing employment in recent years. The share of employment in manufacturing remains significant in all countries, and is not below 18 per cent, save in Turkey. Too rapid a decline in manufacturing employment is not desirable.

Table 3. Labour productivity index in industry (1995 = 100)

Country	1996	1997	1998	1999	2000	2001
Bulgaria	106.36	100.09	96.01	95.95	113.61	...
Czech Republic	102.85	107.87	111.37	111.46	120.61	...
Estonia	107.60	130.81	138.96	142.85	156.06	167.66
Hungary	104.29	113.96	122.55	134.14	161.17	164.95
Latvia	111.77	122.93	137.96	136.19	139.56	...
Lithuania	109.56	113.04	123.53	111.34	119.66	...
Poland	109.07	121.30	126.88	141.84	161.04	...
Romania	105.27	100.18	91.15	95.23	109.95	...
Slovakia	102.49	105.92	114.65	114.58	129.30	...
Slovenia	102.04	107.64	112.79	114.05	121.90	...

Source: UNECE database and author's calculations.

Table 4. Employment in manufacturing

Country	As percentage of total employment	Average percentage change
	2000	1996-2000
Bulgaria	21.6	-5.37 (1996-99)
Czech Republic	27.1	-2.07
Estonia	22.6	-2.80
Hungary	24.2	2.29
Latvia	17.7	-0.72
Lithuania	17.9	-2.57 (1997-2000)
Poland	20.0	-1.88
Romania	19.1	-4.91
Slovakia	25.9	-2.41
Slovenia	31.2	-3.00 (1995-99)
Turkey	14.1	1.40 (1995-99)

Source: ILO (2001), table 2B.

Unit labour costs

The attractiveness of candidate countries to foreign direct investment (chiefly from EU-based enterprises) does not lie in lower relative nominal wages *per se*, but in lower unit labour costs. The labour cost of producing one unit is calculated as a ratio between the nominal wage (a proxy for labour cost paid by the employer) and labour productivity, or output per person employed. Unit labour costs capture the change in the nominal wage in relation to the trend in labour productivity. Table 5 presents indices of unit labour costs in industry for ten candidate countries for 1995-2000. A decline (increase) in unit labour costs

Table 5. Unit labour costs in industry (1995 = 100)

Country	1996	1997	1998	1999	2000
Bulgaria	188.71	2 167.62	2 658.77	2 807.09	2 629.44
Czech Republic	114.45	122.59	130.74	139.31	137.95
Estonia	116.34	114.46	123.56	132.93	134.53
Hungary	116.44	129.59	140.54	145.66	139.40
Latvia	107.64	116.15	121.13	140.31	157.64
Lithuania	116.37	139.63	144.48	170.70	160.81
Poland	115.80	124.97	137.30	133.86	130.75
Romania	150.69	316.82	540.14	744.49	913.65
Slovakia	111.91	118.34	120.07	129.62	125.37
Slovenia	111.78	118.54	125.23	135.35	141.49

Source: UNECE database and author's calculations.

indicates an increase (decline) in the competitiveness of the country in manufacturing. An increase in unit labour costs can be due either to labour productivity falling behind nominal wage increases or, conversely, to wage increments outpacing changes in labour productivity. Excluding Bulgaria and Romania, whose costs have increased precipitously as a result of high inflation, the remaining eight countries registered a steady rise in unit labour costs of 41 per cent on average over 1995-2000, or 7.1 per cent on average per year. The basic reason for this increase is that nominal wages rose faster than productivity growth. This is due partly to the fact that wages started from a low initial level and that a process of catching up in real terms is taking place. However, a moderate rise in unit labour costs, implying nominal wage growth approximately in line with labour productivity growth, is essential to maintaining the comparative cost advantage of manufacturing in candidate countries. Only countries with the capacity to achieve this will maintain their competitiveness and continue to sustain the level of investment and exports required for a high rate of aggregate economic growth.

Structural shifts in employment

As countries open to trade and specialize according to relative factor endowments, structural change in employment is to be expected, with the share in agriculture falling, the share in industry dropping to around 20 per cent, and the share in services increasing. All candidate countries are in the midst of this structural transformation, and accession to and membership of the EU will tend to accelerate this change.⁸ Table 6 presents data on the distribution of employment by sectors for 1995 and

⁸ A good discussion of structural change is found in Landesmann (2000).

Table 6. Employment by sector, 1995 and 2000 (percentages)

Country	Agriculture		Industry		Services	
	1995	2000	1995	2000	1995	2000
Bulgaria	24.4	26.6	32.6	29.1	43.0	44.3 (1996-99)
Czech Republic	6.5	4.9	41.8	39.5	51.7	55.6
Estonia	10.5	7.4	34	33.5	55.5	59.1
Hungary	8.0	6.5	32.6	33.7	59.4	59.8
Latvia	17.4	13.5	28	26.3	54.6	60.2
Lithuania	20.7	19.6	28.5	26.3	50.8	54.1 (1997)
Poland	22.6	18.8	32.0	30.8	45.4	50.4
Romania	40.3	42.8	31.0	26.2	28.7	31.0
Slovakia	9.2	6.7	38.9	37.4	51.9	55.9
Slovenia	10.4	10.8	43.1	37.8	46.5	51.4
Turkey	47.8	45.8	20.7	20.5	31.5	33.7

Source: ILO (2001), table 2B.

2000. A word of caution is required, as table 6 registers formal employment only and ignores informal employment, which could be significant in some sectors. Most countries conform to the expected pattern of declining employment in both primary and secondary sectors, compensated by a rising share in services. However, the differences between countries are perhaps as striking as the pace of change in each of them. Bulgaria, Lithuania, Poland, Romania and Turkey are still characterized by a relatively important share of employment in agriculture. There is little doubt as to the direction of the overall historical pattern of change. However, the important variable is the pace of structural change, as changes in the relative shares of employment need to be congruent with changes in the employment-generating capacity of the sectors that are to absorb labour expelled from the declining sectors. Too rapid a pace of change may lead to unwarranted levels of unemployment. Conversely, too slow a pace could retain labour in low-productivity occupations and, hence, unduly constrain productivity growth.

Special mention must be made of the agricultural sector, as the potential for raising land and labour productivity in agriculture in the candidate countries is likely to be important. However this must be balanced against agriculture's ability to retain labour and the capacity of other sectors to absorb the labour expelled from agriculture. Prevailing age and skill patterns will prevent easy accommodation into non-agricultural activities of labour expelled from agriculture. In this connection, the potential of rural non-farm activities should be borne in mind.

An appropriate pace of change (including in regional terms) will require public policy interventions. There is a clear role for public investment in creating conditions that will attract a balanced pattern and

distribution of private investment. This will have a positive effect on employment, if the employment lost in one sector or industry can be absorbed by others. Enterprise size distribution is another important criterion, hence the need for incentives to small and medium-sized enterprises to establish themselves in those areas and sectors of activity in which more employment can be generated.

Skills and training

An important means of sustaining high labour productivity growth is continuous investment in training and skills upgrading of the workforce. Education and training are important aspects of structural change, as a high level of skills provides an excellent base for adapting to rapid change. The educational level of the labour force in candidate countries (average years of schooling) is relatively high, even compared with EU levels. This should provide a sound basis for investment in upgrading the skills of the workforce. No direct estimates of expenditure on training are available, but two issues are commonly raised. First, in many countries enterprise-based training (whether on the job or enterprise-provided) has simply collapsed for financial reasons. Second, many vocational training institutions are training in skills or using techniques that are considered obsolete, or for which demand is declining. In view of the rapid pace of technological change, which is possibly even more rapid in countries in the midst of a catching-up process, an adequate supply of the right kind of skills is critical. Enterprises should be given incentives to invest in the training of their workers. On the other hand, public institutions should seek to cater to the skills requirements of a rapidly changing economy, including by providing information on recent trends in labour demand by type of skill. In particular, special efforts are definitely required, in order to retrain significant segments of the labour force who will be changing occupations, refreshing their knowledge and skills, or adapting to an entirely new work and technological environment. Clearly, training is an area in which the candidate countries as well as the EU could significantly raise the level of expenditure and increase the number of programmes.

The labour market implications of an adequate balance between demand and supply by type of skill are clear. Bottlenecks are likely to occur in a period of rapid structural change, thereby affecting the unemployment rate. One such dimension is the share of the long-term unemployed. In 2000, nearly half of all the unemployed men and women in ten candidate countries had been unemployed for over a year (table 7). The extent to which long-term unemployment is a reflection of low aggregate demand, a mismatch between the skills of the unemployed and the skills demanded by enterprises, or a consequence of incentives and social benefits that hinder job search are matters for

Table 7. Share of the long-term unemployed in total unemployment (2000)

Country	Total	Male	Female
Bulgaria	53	52.9	53.1
Czech Republic	50	49.1	50.7
Estonia	47.3	48.2	46
Hungary	47.9	50.6	43.6
Latvia	55.9	56.2	55.5
Lithuania	52.4	55.9	47.3
Poland	44.6	40.2	48.6
Romania	49.2	50.2	48
Slovakia	54.7	54.5	54.8
Slovenia	62.7	64.9	60.3

Source: EUROSTAT (2001), pp. 22-23.

closer scrutiny. In view of the low level of average wages, there may be a significant degree of overlap between social benefits and the wages of the low-skilled, reducing job search incentives. In general, the longer a person of working age and in the labour force stays out of active employment, the likelier that that person's skills will become obsolescent. A marked reduction in long-term unemployment must be a priority aim for all candidate countries.

This provides a clear signal of the need to step up training opportunities for persons unemployed for over a year. A policy mix combining training opportunities with active counselling and information on job opportunities has proved quite effective in a number of European countries. However, the experience of some transition countries shows that such measures are often not sufficient. The long-term unemployed should resort to a combination of temporary employment (public works or subsidized employment), on-the-job training, and regular job placement assistance.

A further dimension is involved here. Most candidate countries are experiencing rapid demographic change, with an increase in the average age of the population and of the labour force, and hence in the relative share of the population aged 65+. The implication for the labour market is two-fold. Special attention must be given to upgrading the skills of the persons in employment aged 45+, so that they are not prematurely excluded from employment because of skill obsolescence; older workers' experience is a valuable asset that must be fully used by enterprises. Appropriate incentives to that effect could be considered. Likewise, the skills of the younger generation must be fine-tuned to the requirements of the economy, all of which calls for the constant adaptation of educational and vocational training programmes.

Aggregate growth and employment

As of 1995, most candidate countries entered into a cycle of rapid GDP growth. Table 8 presents indices of GDP growth for all 13 countries for 1995-2001. By 2001, only Bulgaria and Romania had not regained or surpassed the level of GDP of 1995. On average, GDP increased by 25.6 per cent for the 11 countries with positive growth, or a solid 4.7 per cent on an average annual basis. This contrasts with the comparable figure of 2.7 per cent per year for the Euro area as a whole. In principle, should the two percentage points differential be sustained over a sufficiently long period, this would indicate a catching-up with the EU.⁹ The interpretation of the large gap between GDP per capita levels in candidate countries and in the EU (figure 1) calls for caution. It confirms an empirical finding of growth theories on convergence, namely, the lower the initial level of real per capita GDP, the higher the predicted rate of growth (Barro, 1996). However, this convergence is conditional on a set of characteristics and policies over which there is only general agreement.

It is generally believed that rapid growth requires some combination of physical and human capital accumulation, appropriate incentives for research and development, investment in infrastructure, a regulatory framework (whether for private property, financial systems or labour utilization), and an acceptable distribution of national income. Policies should be based on the characteristics of each country and seek to promote an environment conducive to the above elements so that a process of rapid growth is initiated and sustained. One lesson derived from recent experience is that countries cannot expect high growth to set in simply because of low tariff barriers and invitations to foreign capital to invest in recently privatized assets. Economic growth requires a range of active economic and social policies.

One critical dimension is the employment effect of growth. Table 9 presents data on trends in total employment in 12 countries. Only two countries (Hungary and Slovenia) display employment levels for both men and women in 1999-2000 higher than those of 1995 (Turkey is excluded from this count, because of the deep economic crisis that started there in 1999). An additional three countries (Latvia, Malta and Slovakia) show some increase in female employment over that of 1995. Looking at simple averages for all countries, employment has neither decreased nor increased. In most countries the positive economic growth rates have not (yet) been translated into positive employment

⁹ Under the given assumptions, 53 years would be required for the average GDP per capita income of candidate countries to catch up with the EU average.

Table 8. Real GDP growth (1995 = 100)

Country	1996	1997	1998	1999	2000	2001
Bulgaria	89.9	83.5	86.5	88.6	93.7	98.3
Cyprus	102.0	104.6	109.8	114.7	123.8	128.8
Czech Republic	104.3	103.5	102.3	101.9	104.8	108.7
Estonia	104.0	114.8	120.6	119.8	128.1	135.1
Hungary	101.3	106.0	111.1	115.8	121.8	126.4
Latvia	103.3	112.2	116.6	117.9	125.9	134.7
Lithuania	104.7	112.3	118.1	113.5	117.9	124.6
Malta	104.0	109.0	112.4	117.8	122.8	...
Poland	106.0	113.3	118.8	123.6	128.5	129.9
Romania	103.9	97.7	93.0	90.8	92.3	96.8
Slovakia	106.2	112.8	117.4	119.6	122.3	126.2
Slovenia	103.5	108.3	112.4	118.2	123.7	127.4
Turkey	107.4	115.5	119.2	113.2	121.7	114.2
Euro area	...	...	106.4	109	112.7	114.4

Source: UNECE database; IMF (2001), country tables.

Table 9. Total employment (1995 = 100)

Country	Data sources		1996	1997	1998	1999	2000
Bulgaria	Official estimates	Total	100.1	96.2	96.0	93.6	...
Czech Republic	LFS	Male	99.9	99.2	98.0	95.8	95.7
		Female	99.4	97.9	96.1	94.8	94.4
Estonia	LFS	Male	98.0	99.0	96.6	92.3	91.7
		Female	98.9	98.6	98.6	95.0	93.9
Hungary	LFS	Male	99.4	99.7	99.6	102.6	103.6
		Female	98.9	98.4	101.6	104.9	106.0
Latvia	LFS	Male	98.0	102.3	103.6	100.0	95.5
		Female	100.6	106.6	103.5	103.6	103.7
Lithuania	LFS	Total	99.3	96.2	97.9	97.9	93.0
Malta	Administrative records	Male	100.1	99.9	99.7	99.5	...
		Female	103.4	105.7	107.9	110.9	...
Poland	LFS	Male	101.5	103.7	104.6	100.5	98.9
		Female	100.9	101.3	102.8	98.9	97.4
Romania	LFS	Male	99.2	99.6	97.7	96.2	95.8
		Female	96.7	98.4	96.8	97.1	97.4
Slovakia	LFS	Male	103.5	102.0	101.4	97.5	95.3
		Female	103.9	103.7	103.6	101.6	101.1
Slovenia	LFS	Male	98.9	101.9	103.0	101.9	...
		Female	100.2	101.7	102.7	100.2	...
Turkey	LFS	Male	101.8	102.6	104.0	101.2	...
		Female	99.4	84.0	98.2	106.1	...

Note: LFS = Labour Force Survey.

Source: ILO (2001), table 2B.

Table 10. Unemployment rates, measured by labour force surveys (per cent)

Country	1995	1996	1997	1998	1999	2000
Bulgaria	16.5	14.2	14.4	14.1	15.7	16.4
Cyprus	2.6	3.1	3.4	3.3	5.7	4.9
Czech Republic	3.7	4.1	5.4	7.3	9.0	8.3
Estonia	9.7	10.0	9.7	9.9	12.3	13.7
Hungary	10.2	9.9	8.7	7.8	7.0	6.4
Latvia	18.9	18.3	14.4	13.8	14.5	14.6
Lithuania	17.1	16.4	14.1	13.3	14.1	15.4
Malta	3.7	4.4	5.0	5.1	5.3	...
Poland	13.3	12.3	11.2	10.5	13.9	16.1
Romania	8.0	6.7	6.0	6.3	6.8	7.1
Slovakia	13.1	11.3	11.8	12.5	16.2	18.6
Slovenia	7.4	7.3	7.1	7.7	7.4	7.2
Turkey	6.6	5.8	6.9	6.2	7.3	...

Note: Age groups of unemployed may differ. Registered unemployment is recorded for Malta.

Source: ILO (2001), table 3A.

growth. This can be explained (as seen above) with regard to structural and industrial restructuring and adaptation to a market economy. For candidate countries adequately to redistribute the benefits of growth, both real wages and employment will need to grow in parallel. This is necessary for unemployment rates to fall, and for a wider participation in the benefits of growth. One clear implication is that more attention needs to be paid to the pattern of growth, to make it more employment-intensive. This calls for better integration of economic, employment and labour policies.

Table 10 shows that between 1995 and 1999-2000 unemployment rates fell in some countries and increased in others. Unemployment remained high in six countries (Bulgaria, Estonia, Latvia, Lithuania, Poland and Slovakia, with an average rate of 15.8 per cent in 2000), against an average of 6.2 in seven of the candidate countries (Czech Republic, Cyprus, Hungary, Malta, Romania, Slovenia and Turkey). It is noteworthy that unemployment increased in the more recent period (1998 onwards), following an initial decline between 1995 and 1997. The average (11 countries) unemployment rate in 2000 was 11.7 per cent, against 8.4 per cent in the EU-15.

Employment and labour dimensions of nominal convergence

Nominal convergence between candidate countries and the EU refers to the period during which countries concerned meet the nominal

Maastricht criteria and gradually qualify for entry into the European Monetary Union. Thus, nominal convergence is only indirectly linked to membership of the EU, as new member States are expected eventually to join the EMU. Price stability and a low level of inflation are the main requirements of nominal convergence and the gradual fulfilment of the Maastricht criteria. The key question posed by nominal convergence is whether a rate of GDP growth sufficiently high to absorb all available labour in productive employment is compatible with low and stable inflation.

Inflation has dropped significantly in most candidate countries over the past five years. In 2001, seven countries had annual rates of consumer price inflation below 6 per cent per year, and four between 6 and 10 per cent per year. Only Romania and Turkey experienced double-digit inflation (table 11). Excluding these two countries, the average increase in consumer prices in 2001 was 5.3 per cent, or slightly more than double the rate registered in the EU. Whether the underlying inflation in recession countries is currently on a sustainable path is an issue for debate. In a high-inflation environment (over 20 per cent per year, for instance), wage policy would seek primarily to maintain the purchasing power of wages. This is what is observed in Romania. In a low-inflation environment (basically at a one-digit rate of inflation), real wage increases would seek to match labour productivity increases in the most dynamic sectors, usually manufacturing. Such wage increases will inevitably spread to the rest of the economy, thereby raising underlying wage inflation.

Table 11. Average annual percentage change in consumer prices

Country	1999	2000	2001
Bulgaria	2.6	10.2	7.3
Cyprus	1.6	4.2	2.0
Czech Republic	2.1	3.9	4.7
Estonia	3.5	3.9	5.8
Hungary	10.1	9.9	9.2
Latvia	2.4	2.8	2.4
Lithuania	0.8	1.0	1.5
Malta	2.1	2.4	4.1
Poland	7.4	10.2	5.5
Romania	45.9	45.7	34.5
Slovakia	10.5	12.0	7.3
Slovenia	6.3	9.0	8.6
Turkey	64.9	54.9	54.4
Euro area	1.1	2.3	2.5

Source: UNECE database; IMF (2001), country tables.

Macroeconomic effects of productivity and wage differentials

Large productivity and wage differentials between sectors exposed to international trade (tradables) and sectors sheltered from international trade (non-tradables) may be observed in countries engaged in catching up with economically more advanced countries. This development (known as the Balassa-Samuelson effect)¹⁰ predicts that fast productivity growth in tradables will lead to rapid wage increases in both tradeables and non-tradeables as a result of wage equalization across the economy. Since productivity growth will be much slower in the non-tradeables, this will unleash inflationary pressures, leading to a real appreciation of the exchange rate. This real appreciation can be absorbed either through a nominal appreciation of the exchange rate, provided countries have the required flexibility to adjust their exchange rate, or through higher inflation. Both these options collide with the convergence criteria implying a rate of inflation aligned with the EU rate and a stable nominal exchange rate. Available data suggest that candidate countries are indeed experiencing real exchange rate appreciation – 21 per cent on average over 1995-2000 (table 12). In view of the considerable gap between GDP per capita levels in the EU and in candidate countries, further real exchange rate appreciation may be expected, as countries embark on rapid economic growth to bridge the gap. This is doubly problematic for candidate countries, because of the importance of nominal convergence for future membership of the EMU, and because this will tend to appreciate unit labour costs in foreign currency terms. Future foreign investment prospects could thus be harmed in this way.

A practical illustration of the Balassa-Samuelson effect is the case of Ireland in early 2001, when that country was given a warning from the EU Economic and Financial Council regarding its pro-cyclical policies in the face of a tight labour market and a sharp rise in inflation. Buoyant growth in Ireland throughout the 1990s had put pressure on available labour supply, thereby fuelling higher wage demands. Given its membership of the EMU, the only policy instruments available to Ireland were fiscal policy and incomes policy. Another option would be to increase labour supply, either through raising the employment rates of women and older persons, or through labour migration. Candidate countries could well find themselves in a similar situation. The alternatives are either to adopt a contractionary fiscal stance, or to raise the level of labour supply. This is a good illustration of the close integration

¹⁰ For a good discussion on the theory and practical implications of the so-called Balassa-Samuelson effect for transition economies, see UNECE (2000), pp. 54-59; and UNECE (2001), ch. 6.

Table 12. Real effective exchange rates (based on producer price index) (1995 = 100)

Country	1996	1997	1998	1999	2000
Bulgaria	96.98	103.31	122.76	125.08	132.42
Czech Republic	107.32	105.26	111.37	109.88	110.77
Estonia	115.64	116.97	123.63	122.76	121.13
Hungary	100.24	109.70	108.86	108.24	109.63
Latvia	114.43	121.32	126.17	127.63	133.05
Lithuania	117.47	129.25	127.37	138.08	168.15
Poland	108.63	109.29	112.80	109.86	115.94
Romania	98.43	111.02	125.52	105.86	121.65
Slovakia	104.24	106.65	109.04	100.19	104.21
Slovenia	97.62	95.73	99.87	96.74	90.32

Source: UNECE database and author's calculations.

of macroeconomic policy and labour market policy, and of how they affect one another.

UNECE estimates a likely real exchange rate appreciation of 3 per cent per year (UNECE, 2001). Other authors disagree with this analysis, arguing that underlying inflation in candidate countries is quite low, with the actual rates of inflation linked much more to structural change and external shocks, such as oil price increases (Arratibel et al., 2002).

Labour market implications of a parallel pursuit of real and nominal convergence

The position of the European Central Bank (ECB) is that nominal and real convergence should be pursued in parallel. Both monetary policy and exchange rate policy should seek “to support the parallel pursuit of real and nominal convergence” (Padoa-Schioppa, 2002, p. 2). In practice, this implies a rate of economic growth compatible with the stability criteria of the Maastricht Treaty allowing countries to qualify for entry to the EMU. The ECB’s argument is that the surest route to sustainable non-inflationary growth is compliance with nominal convergence. The question here is not whether real convergence should be exclusive of nominal convergence, or vice versa. The real question is how to ensure the maximum possible coherence between the two. The explicit costs of one or the other must be addressed. Rapid economic growth could undoubtedly lead to inflationary pressures that would have negative implications for future growth. Conversely, nominal convergence could stifle growth through deflationary monetary and fiscal policies that would push back real convergence. Each country will need to define the level of growth deemed appropriate within an acceptable inflation target. Whatever the choices, it is important to bear in mind

the employment and labour market aspects of these policies. Several elements bear mention here.

Employment as a central policy objective

The ILO's Employment Policy Convention, 1964, (No. 122) calls for each Member to "declare and pursue, as a major goal, an active policy designed to promote full, productive and freely chosen employment" (Article 1). Candidate countries should fully apply this principle and render explicit the employment implications of accession to the EU. The costs and benefits for employment of alternative routes to accession should be examined and discussed. In particular, the potential conflict between the process of real and nominal convergence and its employment implications needs further analysis. Closer trade integration between candidate countries and the EU is bound to influence the level and composition of employment, in terms of the regional, sectoral and establishment-size distribution. Likewise, the employment aspects of the mobilization of domestic savings and investment for accelerated growth require closer investigation, as countries, depending on size, should not rely exclusively on accession and trade integration as sources of growth.

The case for coordinated wage bargaining

An important objective for candidate countries is to achieve a rate of growth that will reduce unemployment and raise living standards without undesirable inflationary pressures. One critical aspect of this difficult combination is coordinated wage bargaining. During the 1990s, a number of EU countries (foremost among them Denmark, the Netherlands and Ireland) showed that low inflation, high growth and low unemployment were compatible. This is attributed largely to the presence of strong employers' and workers' organizations, and to their ability to coordinate wage agreements compatible with the overall macroeconomic constraints in each country. Regardless of the degree of centralization of wage bargaining (which is usually a reflection of the level of organization and the strength of employers' and workers' organizations), the degree of coordination of wage bargaining is the important variable.¹¹ The experience of these European countries is contrary to the widely held view regarding European labour market rigidity, whereby low inflation can only be achieved at the cost of a relatively high level of unemployment. Coordinated wage bargaining can

¹¹ Trade union density (union membership as a percentage of all wage employed) was 43 per cent on average in the EU-15 in 1995 and 49.8 per cent in (9) candidate countries (ILO, 1997).

sustain real wage increases in a context of low inflation, with positive implications for employment levels. Extensive consultation between the government and the social partners on economic and social policies is characteristic of these three European countries.

This experience is directly relevant to candidate countries. First, these countries will continue to experience rapid structural change, with some sectors modernizing more rapidly than others. This will be accompanied by the prospect of wider wage differentials. Large inflows of foreign direct investment will tend to fuel such differentials, and pressures for wage equalization will therefore intensify. Second, inflation expectations will tend to be tied to past inflation rather than to future inflation, given a reasonable degree of uncertainty about the pace of the latter. Third, the prospect of accession to the EU will stimulate demands for a rapid catch-up in living standards, wages and social benefits. These could quickly overtake what economic growth may permit. For all these reasons, it seems important for candidate countries and their employers' and workers' organizations to be in a position to effectively coordinate bargaining over wage increases, so as to ensure they are compatible with a high rate of economic growth and a low level of unemployment.

Labour productivity, flexibility and labour standards

A sustained increase in labour productivity is central to sustaining high levels of economic growth within a pattern of nominal convergence for entry into the EMU. At the same time, candidate countries need to raise their levels of employment, notably of gainful employment. These objectives may be seen as conflicting. Labour productivity is dependent on many factors, from technology to work organization, the skills of the labour force, the sectoral composition of output, and so forth. It is also highly dependent on trust and cooperation and security in employment. High levels of labour productivity and high levels of labour insecurity are not compatible. However, rapid structural change of the kind experienced by candidate countries requires a certain degree of flexibility, in order to enable labour mobility within enterprises and across occupations, sectors, regions and skills. Such flexibility can be achieved on the basis of a shared commitment to labour standards, particularly with regard to labour mobility. Whereas labour standards are sometimes perceived as being part of the problem of rigid labour markets, they can provide a legitimate basis for the flexibility required in rapidly changing economies (Sengenberger and Campbell, 1994). Rapid reform and structural change require a high degree of trust and cooperation within enterprises, between employers' and workers' organizations, and between these and the government at various levels. One example is the industrial restructuring that occurred

in several EU countries during the 1980s which greatly benefited from the flexibility provided by a broad commitment to labour standards. Negotiated flexibility is a strategy applied in several countries with positive results. Some of the more important labour standards in this context are those relating to social dialogue and collective bargaining, minimum wages to prevent downward wage competition, equality of opportunity, occupational safety and health, as well as employment protection, social security and unemployment benefits. In various countries, active labour market policies combining training opportunities with orientation and counselling have proved effective in securing employment flexibility and income security.

Labour supply

All candidate countries (except Turkey) are faced with a rapidly ageing population and, hence, low labour force growth. The full use of existing labour force supply should therefore be a major concern. Countries need to consider increasing the labour force participation rate, or maintaining high levels of participation. Labour force participation rates in eight out of 12 countries are lower than the average for the EU (table 13). This is due not to lower female labour force participation (eight countries show higher rates for women than the EU average), but to lower male participation rates in all 12 countries but one, the Czech Republic. An important objective of labour market policy is to enable the return to employment of all those wishing to work.

A similar picture emerges when looking at employment rates (or employment to working-age population ratios) (table 14). Compared

Table 13. Labour force participation rates (15-64 years, 2000)

Country	Total	Male	Female
Bulgaria	58.89	63.27	54.62
Czech Republic	71.40	79.21	63.57
Estonia	70.79	76.67	65.30
Hungary	60.25	68.05	52.72
Latvia	67.55	72.47	62.99
Lithuania	70.94	75.04	67.09
Malta	38.40	55.70	21.50 (1999)
Poland	65.76	71.72	59.94
Romania	68.58	75.40	61.85
Slovakia	69.66	75.96	63.46
Slovenia	67.85	72.25	63.34 (1999)
Turkey	54.82	77.90	32.76 (1999)
EU	69.50	78.90	59.80

Table 14. Employment to working-age population ratios, by age and sex (2000)

	All				Male				Female			
	15-24	25-54	55-64	15-64	15-24	25-54	55-64	15-64	15-24	25-54	55-64	15-64
Bulgaria	19.3	67.3	18.9	49.2	21.3	69.4	31.1	53.4	17.3	65.2	8.5	45.3
Czech Republic	36.4	81.5	36.1	64.9	39.3	89.2	51.6	73.1	33.6	73.7	22.1	56.8
Estonia	27.4	76.8	43.0	60.6	31.4	79.5	50.2	64.3	23.2	74.2	37.5	57.1
Hungary	33.1	72.8	21.9	55.9	37.0	79.0	33.0	62.7	29.2	66.7	13.0	49.4
Latvia	30.4	74.2	35.4	58.2	35.2	75.4	48.3	62.3	25.6	73.0	25.9	54.3
Lithuania	26.7	76.0	42.2	60.1	30.2	75.1	52.2	61.8	23.2	76.8	34.5	58.5
Poland	24.1	71.0	29.0	55.1	26.4	77.5	37.4	61.2	21.9	64.5	21.8	49.3
Romania	34.0	78.6	52.0	64.2	36.9	84.6	57.4	69.5	31.1	72.7	47.3	59.0
Slovakia	28.3	74.2	21.5	56.3	28.7	79.1	35.2	61.6	27.9	69.3	10.2	51.1
Slovenia	31.2	82.6	22.3	62.7	34.7	85.5	31.0	66.7	27.4	79.6	14.3	58.5
Turkey	36.3	56.2	35.3	48.2	49.1	84.9	51.4	71.2	23.9	26.6	19.9	25.1
EU-15	40.8	76.6	38.5	63.6	44.8	87.5	48.9	73.2	36.7	65.7	28.4	53.9

Source: EUROSTAT (2001), pp. 20-21; OECD (2001), statistical annex.

with the EU-15 average, candidate countries have lower employment rates for young people and for women aged 55-64. Conversely, the employment rates of women aged 25-54 are higher than the EU average, but those of men are generally lower.

These two sets of data suggest that there is still scope for candidate countries to raise the employment rates of distinct segments of the labour force, in order to sustain an adequate level of supply. Raising the employment rate of specific categories of the labour force is not simply a question of higher levels of aggregate demand. Specific policy tools are required to remove the obstacles that particular segments of the labour force may face in the labour market. This is especially the case for women workers, whose participation rates were and remain relatively high, and who are highly dependent on continued access to support structures for childcare.

The case for active labour market policies

In a period of rapid structural change, labour market policies are required to maintain an adequate equilibrium between labour demand and supply, notably by enabling entry and re-entry into employment. As shown above, levels of labour demand can differ considerably in terms of sex, age, skill and regional composition. Labour market policies implemented at the interface between labour legislation, labour market institutions and the labour market should seek to redress any imbalances that may occur. Strict reliance on the market is likely to be inefficient, in view of the many imperfections that arise in the allocation of labour (inadequate information, transaction costs, mobility constraints and segmentation). In each country, labour market policies

need to strike a balance between employment and social protection, stability and mobility, income security and employment flexibility. There is a general tendency to contrast low levels of protection and high levels of labour market flexibility, on the one hand, with higher levels of protection and lesser flexibility in the labour market, on the other. An interesting approach adopted by several Nordic countries combines low employment protection, high income security in the form of unemployment benefits, and active training and counselling in job search. Recent research suggests that income insecurity, rather than strict employment protection, is a factor in the lower labour mobility in transition countries (Cazes and Nesporova, 2001). Greater employment mobility could be encouraged through greater investment in training opportunities for young workers and in retraining for experienced workers. Early retirement options, as well as the conditions of unemployment benefit systems and social welfare systems (replacement rates, duration and entitlement criteria) may need to be reviewed. For policies to be adapted to changing labour market conditions, a high degree of consultation with employers' and workers' organizations is usually required. In periods of rapid structural change, such consultations may provide the key to an appropriate combination of flexibility and protection in the labour market.

Conclusions

The success of an enlarged European Union rests on the candidate countries' capacity to achieve rapid, non-inflationary economic growth, rising levels of employment, real wages and social protection in conditions of macroeconomic stability. This amounts to sustaining competitiveness on the basis of decent work.

Four aspects of the question have been highlighted here. Full participation by employers' and workers' organizations, through extensive and coordinated social dialogue, in the combined consideration of wage adjustments and employment is critically important in aligning nominal and real convergence. High levels of employment are the best means of broadening participation in the benefits of growth and of equitably sharing the tax burden needed to finance social and infrastructure expenditures. Competitiveness requires sustained increases in labour productivity. These cannot be sustained if employment security, social protection, trust and cooperation are inadequate. Finally, labour standards are an invaluable means of balancing security and flexibility at a time of rapid structural change.

As candidate countries seek to comply with the nominal convergence criteria defined by the European Union in order to qualify eventually for entry into the EMU, their macroeconomic policy options will be reduced. Fiscal policy, and possibly incomes policy, will be the only

instruments over which some degree of autonomy will be retained. A labour market policy of the kind discussed here will be an important means of regaining some space for macroeconomic policy, and of ensuring the requisite coherence between real and nominal convergence. Fiscal policy itself will be quite dependent on the levels of employment and of wages, and on the degree of social cohesion that labour market policy and fiscal policy can jointly foster.

The precise combination and integration of economic and social policies will depend on the situation prevailing in each country. However, countries can usefully draw on past and present experience in other European and transition economies. Opportunities for sharing such information should be actively pursued, including through the ILO.

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