STUDIES ON GROWTH WITH EQUITY

EUROZONE JOB CRISIS :
TRENDS AND POLICY RESPONSES

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FOREWORD

This report, carried out in response to a mandate by the Governing Board of the International Institute for Labour Studies, analyses the role of well-designed policies in supporting job-rich recovery in the Eurozone.

It has been prepared by Vincenzo Spiezia, Steven Tobin, Raymond Torres, Stefan Kühn, Elva López Mourelo, Clemente Pignatti, Daniel Samaan and Verónica Escudero, from the Institute, with Raymond Torres acting as coordinator for the project. Box 2 and Table 4 include inputs from the ILO Trends Unit (Bourmpoula E., Ernst E. and Mahmood M., under the guidance of José Manuel Salazar-Xirinachs) and Box 3 has been provided by Gianni Rosas.

The project has benefited from guidance of the ILO Director-General. Excellent comments by the European Commission, Directorate General for Employment, Social Affairs and Inclusion, as well as from Philippe Egger, Rudi Delarue, Rafael Díez de Medina, Stephen Pursey and, especially, the ILO Regional Office for Europe and Central Asia, under the leadership of Susanne Hoffmann, are acknowledged. The views expressed in the report, which is published under the responsibility of the Director of the Institute, do not necessarily reflect those of the Organization or its constituents.

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EXECUTIVE SUMMARY

Employment remains depressed in the majority of Eurozone countries …

Labour markets in the Eurozone have not yet recovered from the global crisis that hit the world economy in late 2008. Total employment remains 3.5 million lower than before the crisis. Most alarming, following a modest recovery in 2010 and 2011, employment has fallen since the start of 2012 in half of the Eurozone countries for which recent data are available. By April 2012, the Eurozone unemployment rate reached 11 per cent, representing 17.4 million jobseekers.

Some countries have been hit more severely than others. Job losses were especially acute in southern Europe. Austria, Belgium, Germany, Luxembourg and Malta are the only countries where employment is now higher than in 2008. However, even in these countries, there are signs that the labour market situation may no longer be improving. The quality of jobs has deteriorated as well, even in many of the relatively successful economies.

… and a further 4.5 million jobs may be lost …

The report shows that by embracing a Eurozone growth strategy with jobs at its core, a recovery is still possible within a single-currency setting. Repairing the financial system, promoting productive investment, reinforcing effective employment programmes, maintaining social protection, fostering social dialogue and undertaking job-friendly fiscal plans would bring the Eurozone out of the austerity trap and pave the way for a sustainable recovery with social cohesion.

If the current policy course does not change quickly, however, it is possible that a further 4.5 million jobs will be lost over the next four years. This would risk further feeding social unrest and eroding citizen's confidence in national governments, the financial system and European institutions.

Mounting evidence points to the fact that a prolonged labour market recession may be in the making. Long-term unemployment is on the rise and many workers are becoming excluded from the labour market. At the beginning of 2012, around 31.5 per cent of the working-age population in the Eurozone were either unemployed or inactive --an increase of 1.5 percentage points from 2007. And 44 per cent of unemployed people had been without work for more than one year.

Young people are increasingly at risk of a scarring first experience in the world of work, which could affect them for the rest of their life. In April 2012, the youth unemployment rate in the Eurozone was over 22 per cent. It exceeded 30 per cent in Italy, Portugal and Slovakia and was over 50 per cent in Greece and Spain. Youth unemployment rates also remained relatively high in successfully performing countries, such as Belgium and Malta.

Without a prompt policy turn – to address the crisis and to regain the trust and support of workers and enterprises – it will be difficult to implement the reforms necessary to put the Eurozone back onto a path of stability and growth.

… questioning the primacy of fiscal goals as the backbone of the policy strategy.

There is growing awareness that an approach based narrowly on fiscal austerity will affect employment, while also failing to cut fiscal deficits significantly. Economies with a more growth-oriented policy strategy show better performance in terms of jobs, investment and financial stability. More fundamentally, the conditions under which fiscal austerity might have worked have simply not been met.

Fiscal austerity has encompassed sharp cuts in public investment and in pro-employment programmes, thereby affecting domestic demand directly. The pace and scale at which these measures were introduced has outweighed any positive demand components, inducing an overall recessionary effect. As more and more countries shift to fiscal austerity, the scope for exports to outweigh austerity-driven declines in domestic demand has become very limited.

Similarly, 13 out of 17 Eurozone countries have carried out labour market flexibility reforms, often in the direction of easing dismissals. However, in a depressed macroeconomic context, these reforms are likely to lead to increased numbers of layoffs without any boost to job creation at least until economic recovery gathers momentum.

The austerity approach has side-lined the much-needed reform of the financial system, the epicentre of the crisis. Indeed, action on this front has proceeded slowly. The result is that, in countries, hit by recession, banks have not resumed their normal role of providing loans to the real economy. In 2011, private investment as a percentage of GDP fell in all Eurozone countries except one, despite low interest rates and the ample liquid assets held by large firms. The trend is especially problematic for small firms, which account for over two-thirds of employment in the Eurozone.

Finally, significant cross-country differences in competitiveness remain within the Eurozone. While unit labour costs have converged somewhat since the start of the crisis, little attention has been paid to the role that a coordinated growth and jobs strategy could play in attenuating intra-Eurozone competitiveness imbalances.

Addressing the jobs crisis in the Eurozone requires, first, repairing the financing system urgently …

No recovery will be possible unless the financial system is repaired. In past expansionary episodes, an increase in investment equivalent to 1 per cent of GDP had been associated with an additional 1.4 million net new jobs in the Eurozone as a whole over around two years. This suggests that if credit channels were restored and the ratio of investment to GDP was brought back to its pre-crisis level (meaning a rise in the investment to GDP ratio by less than two percentage points to 21.5 per cent), around two-thirds of the jobs lost since the start of the crisis would be recovered.

Repairing the financial system means addressing quickly the solvency problems of many banks. There is a strong case for moving towards banking union, provided that the shareholders of ailing banks – which, along with the managers they elected, have prime responsibility for the toxic practices that prevailed and generated large dividends in good times – contribute to cover the losses. The involvement of large bondholders may be necessary as well. This is all the more important because bank restructuring will inevitably lead to increased public liabilities. The Eurozone Summit Statement of June 29th provides a step in the right direction, which however requires concrete follow-up measures.

A new regulation to prevent any recurrence of past inappropriate practices is also called for. This means reinforcing prudential control at the Eurozone level, addressing excessive risk taking and remuneration practices not linked to the performance of the sector, clarifying responsibilities for the current state of some banks and taking economic and legal action as needed, and ensuring that banks focus on their original intermediary role instead of developing own-account activities. Here too, recent proposals by the European Commission go in this direction, but require concrete follow up action. It will also be necessary for the European Central Bank to take a stronger role in this area.

… second, promoting growth and jobs, taking into account initial country conditions, including through well-designed investment and income policies …

Promoting investment would go a long way towards improving job prospects in countries hit by the crisis, restoring competitiveness and reducing internal Eurozone imbalances. This requires improving credit conditions for small enterprises and strengthening or creating systems of guarantees for loans to these firms, as well as public incentives for investment or direct public investment with a potential to crowd-in private initiatives and create jobs. Launching a reindustrialization strategy in these countries would help to improve coherence between the different policy instruments.

Surplus countries have room to rebalance growth in order to cushion the effects of weaker demand from crisis-hit countries and to support the overall adjustment in the Eurozone. A rise in wage rates in line with productivity growth, as has started to happen, would contribute significantly to the rebalancing process. Addressing the high incidence of non-standard employment would also help.

Deficit countries, on the other hand, have restored cost-competitiveness to some extent. On average, half of the relative increase in unit labour costs since the introduction of the Euro has been reversed since 2008. This has come about through real wage cuts and labour productivity improvements. Prices, on the other hand, have adjusted only slightly, thereby weakening the effect of reduced unit labour costs on competitiveness in deficit countries and adding to the hardship of those whose incomes have fallen.

Going further, addressing competitiveness problems without provoking a deep and long recession will require measures that boost productivity and achieve price moderation in deficit countries, and a recovery in wages in surplus countries after a number of years in which wage rises lagged behind productivity. Furthermore the overall internal Eurozone rebalancing should not weaken the region's competitive position with other counties.

In all cases, there is a significant role for social dialogue on incomes policy. Far from preventing adjustment, coordinated collective bargaining would facilitate the transition to a more competitive Eurozone while boosting confidence that responses are fair. In this respect, recent moves in some countries to weaken or suspend collective bargaining are counterproductive.

… effective employment programmes, notably youth guarantees …

Employment policies, notably well-designed active labour market programmes, could play an instrumental role in promoting job recovery. Making sure that young people are not trapped in precarious jobs is important as well. Some countries, such as Austria, have found ways to ensure that temporary jobs are stepping stones to more stable arrangements – instead of a dead-end. This requires careful design of regulations.

In a number of Eurozone countries, such as Austria, Belgium and the Netherlands, new training programmes have facilitated school-to-work transition and ensure that young women and men remain connected to the labour market. Here, the successful delivery of these programmes will hinge on the availability of well-resourced public employment services.

The launch of a special programme for youth unemployment, along the line of the "youth guarantees" in Nordic countries, is particularly urgent. Under such guarantees, the government commits itself to offer young women and men in a defined target group – unemployed, not in education or with a short employment experience – a place in an education, training or work programme or special job-search support. No young person would thus be left behind, for a budget cost estimated at less than 0.5 per cent of Eurozone government spending. In Sweden, 46 per cent of young jobseekers had successful job outcomes as a result of the guarantee.

… realistic fiscal plans to support jobs while meeting deficit goals in the medium term …

It is essential to bring fiscal deficits down to sustainable levels in the medium-term. Yet, the pace and nature of deficit reduction measures can complicate the achievement of budget goals. This is why a job-friendly fiscal consolidation approach would not only be socially responsible but would also contribute to boost economic growth and to meet budget goals.

In particular, some of the above-mentioned policies require fiscal support. This may be partly compensated by cuts in wasteful spending or by tax measures. In this regard, the broadening of the tax base on property or certain types of financial transactions would be especially timely, as these taxes are less distortive than taxes weighing on work and real investment. Refocusing European Structural Funds on jobs and mobilizing the European Investment Bank to support investment projects would also represent strategic moves. More importantly, the evidence presented in the report shows that such a policy would be rewarded by better job prospects and improved fiscal balances in the medium term.

… and third, greater policy coordination in the Eurozone to support the common currency .

The current crisis has made it clear that in a globalized world economic shocks ignore national borders and that economic imbalances in one country are easily spread to the whole Eurozone and beyond. It is essential that the risk arising from the sovereign debts and the undercapitalization of private banks be addressed in a coordinated manner.

Citizens are losing confidence in governments' capacity to manage economies. Citizens and governments question the rationality and probity of financial markets which in turn are losing confidence in governments' ability to finance fiscal deficits. "Confidence" is thus a complex of relationships which requires a comprehensive and coordinated policy effort by Eurozone members.

The reinforcement of the relevant Eurozone and EU institutions is therefore of the essence. Greater coordination may have started to happen, as exemplified by the Eurozone Summit Statement of end June. Earlier on, in April 2012 the European Commission adopted an Employment Package with the aim of supporting growth and jobs, strengthening EU institutions and the position of social partners and creating a genuine EU labour market. The European Commission's proposed Action for Stability, Growth and Jobs, released in May 2012, further develops this new approach. In particular, the Action recommends that Member States "ensure that their wage setting mechanisms appropriately reflect productivity developments and stimulate job creation" and calls for greater implementation of active labour market policies.

Such an approach, by arresting the onset of a vicious downward spiral and starting a virtuous spiral of increasing employment, can facilitate recovery and restore competitiveness. It can also contribute to the application of the EU Treaty's horizontal social clause, and to the promotion of social dialogue and the rights and principles guaranteed by the EU Charter on Fundamental Rights, the conventions of the Council of Europe and ILO international labour standards, all widely ratified in the EU.

The extent to which the Eurozone problems can be addressed depends also on the ability of other major global players to support sustainable recovery, especially those where exports to developed countries had been the main driver of growth. Exacerbated financial stress in the Eurozone would have dramatic consequences for the rest of the world economy.

In general, the depth of the adjustments required to end the crisis is such that any policy strategy also needs to have the support of social partners in order to be credible. In this respect, social dialogue is not only a means for ensuring an equitable distribution of the efforts necessary for the recovery and thus citizens' confidence in governments, but also a key "collateral" for investors.

A jobs pact is vital for the stability of the Eurozone as a single-currency area.

The crisis has raised enormous challenges for the Eurozone. There are risks concerning its stability as a single-currency area. The report shows that further financial stress in the Eurozone would lead to significantly higher unemployment in the short-run, both in deficit countries and in their surplus counterparts. All countries would lose, so every country has an interest in changing policy course. And contagion to the other EU labour markets and the entire world economy would be unavoidable.

The report shows that by embracing a Eurozone growth strategy with jobs at its core --along the lines described above-- a recovery is still possible within a single-currency setting. The ILO Global Jobs Pact and Call for action on youth, as recently launched by the International Labour Conference, offer a portfolio of policies on which Eurozone countries could continue to draw. Other global players, especially those that have relied on export-led growth, also have a role to play to support balanced recovery.

The window of opportunity is closing. However, the experience of Sweden, which overcame its financial crisis in the early 1990s through an inclusive strategy, shows that a positive dynamic can be put in motion. Such a growth and employment strategy would be instrumental in boosting confidence in the sustainability of the Eurozone as a single-currency area.

1 NEW CLOUDS ON THE EUROZONE EMPLOYMENT HORIZON

In the aftermath of the global crisis, employment in the Eurozone reacted relatively well …

In the aftermath of the global financial crisis which erupted in September 2008, the Eurozone labour market performed somewhat better than that of other advanced economies. In 2009, total employment in the Eurozone dropped by less than 2 per cent. This is equal to the fall in employment in the EU as a whole and significantly less than in the United States.

… but the situation has reversed since the shift to austerity …

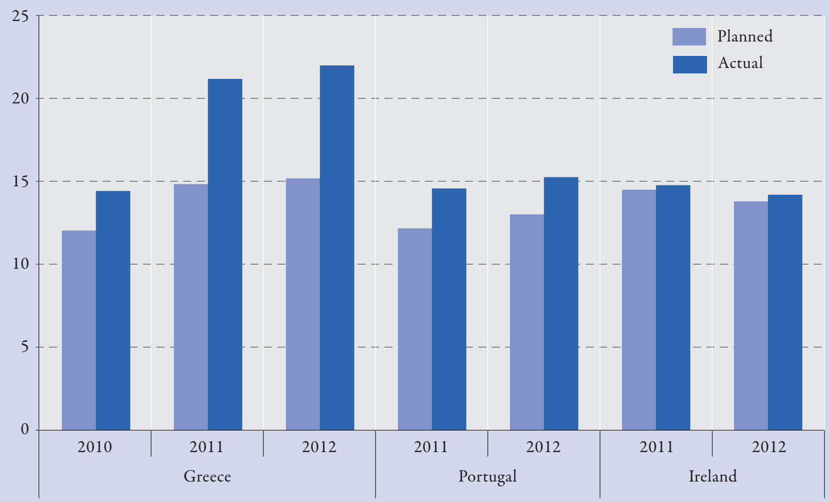
Ever since, however, the Eurozone labour market has deteriorated. Employment recovered slightly during 2010 and the first part of 2011, but it entered a double dip from the end of 2011 – unlike the trend in other advanced economies, where there has been a gradual (although insufficient and fragile) rise in employment.

The recent negative trends in Eurozone labour markets have coincided with the shift to fiscal austerity policies. In particular, in Greece, Ireland and Portugal – the three Eurozone countries under an Adjustment Programme agreed with the European Commission, the European Central Bank and the International Monetary Fund – employment losses have tended to accelerate. Unemployment rates in these countries have grown faster than was planned in the Programmes (figure 1).

These trends are not surprising. Already in June 2010, the ILO Director-General warned that a "jobs recovery may be at risk" (ILC, 2011).

Overall, employment in the Eurozone remains well below pre-crisis levels. In the two years that followed the onset of the crisis, total employment in the Eurozone dropped by over 4 million, and since then only one-quarter of the losses have been recovered.

Figure 1 **Planned and actual unemployment rates in Adjustment Programme countries***



* Planned unemployment rates are unemployment rates projected under the Adjustment Programmes agreed between the "troika" (EC-ECB-IMF) and Greece, Ireland and Portugal. Actual unemployment rates in 2012 refer to April 2012 for Ireland and Portugal and to March 2012 for Greece.

Source: IILS estimates based on Eurostat, Labour Force Survey and European Financial Stabilisation Mechanism.

These patterns hide significant cross-country differences (figure 2). Germany, Luxembourg, Malta and, to a lesser extent, Austria are the only Eurozone countries where the employment rate – the proportion of working-age people who have a job – has increased since the start of the crisis. The employment rate has increased recently in Belgium, Estonia, Finland, the Netherlands and Slovakia, but not enough to reverse the earlier falls. In Cyprus, France and Italy, the employment rate has declined somewhat since the start of the crisis. Finally, in Greece, Ireland, Portugal, Slovenia and Spain the employment rate has declined significantly, in some cases reversing all the gains made during the expansionary phase between 2000 and 2007.

Figure 2 **Employment rates** (proportion of working-age persons who have a job, percentages)

Source: IILS estimates based on Eurostat, Quarterly Labour Force Survey.

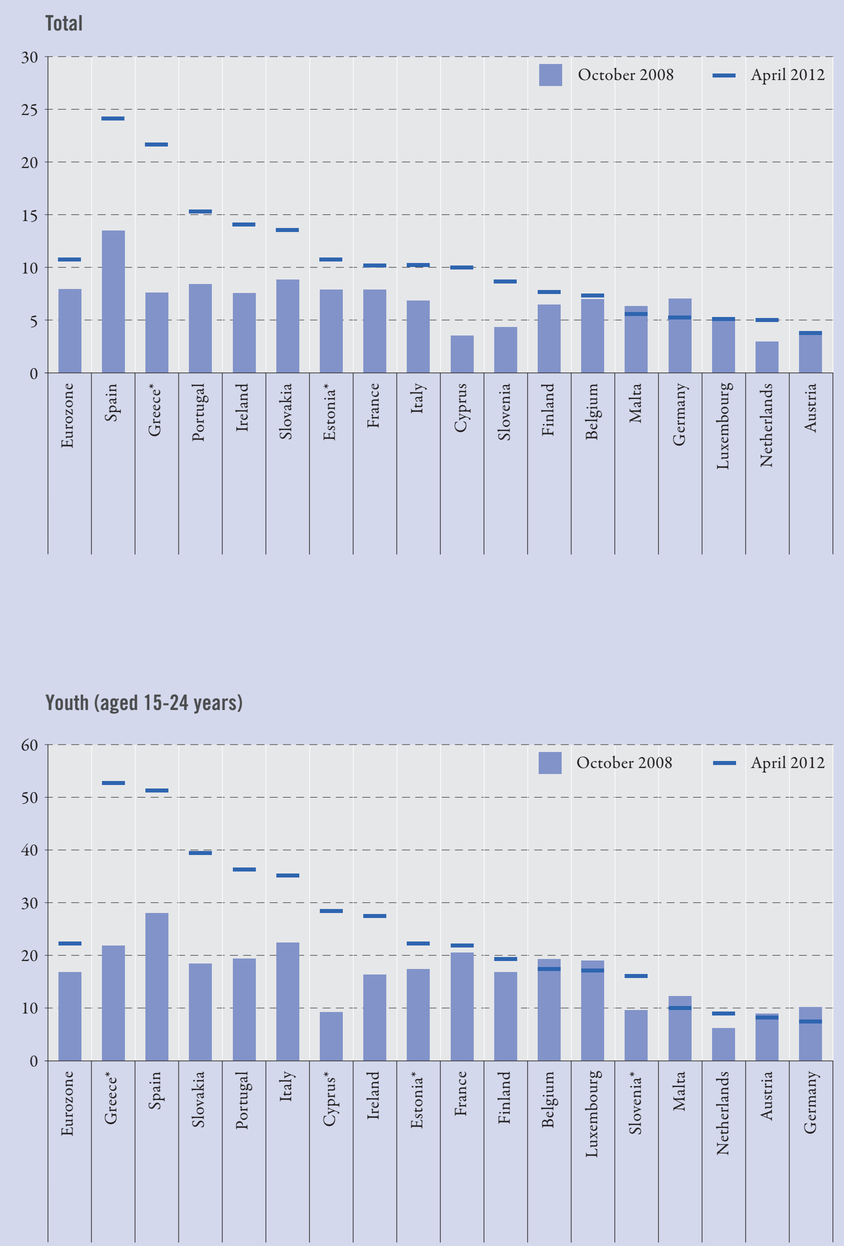
The depressed employment situation has been accompanied by growing job precariousness for those who have a job. Involuntary part-time work has risen significantly in 12 out of the 17 Eurozone countries; the incidence of temporary employment has tended to increase in countries where job creation has resumed; and an examination of the nature of jobs created between 2007 and 2010 in the countries for which data exist shows that the majority of new jobs are remunerated below average wages (IILS, 2012). This is particularly the case in Germany, the Netherlands and Spain. Furthermore, the analysis shows that new low-paid jobs are less stable than new high-paid jobs.

… so unemployment is on the rise in the majority of Eurozone countries, particularly among youth …

The unemployment rate in the Eurozone increased by 3.1 percentage points, from 7.9 per cent in October 2008 to 11.0 per cent in April 2012, when over 17.4 million people were unemployed (figure 3). Unemployment rates have reached historical highs in Greece, Ireland and Portugal (the three "programme countries"). Germany and Malta are the only countries where the unemployment rates are lower than in 2008, but even there the most recent trends are negative.

Unemployment rates have increased most among young people. Between 2008 and 2012, youth unemployment rates in the Eurozone increased by 5.4 percentage points, to reach 22.2 per cent. Long-term unemployment in the Eurozone has dramatically increased as well. The incidence of long-term unemployment has risen from 38.6 per cent of total unemployment in the third quarter of 2008 to 45.5 per cent in the same quarter of 2011. Both women and men have been affected by these trends.

Figure 3 Unemployment rates (percentages)



* Data are for December 2011, instead of April 2012.
Source: IILS estimates based on Eurostat, Quarterly Labour Force Survey.

… and the situation is likely to worsen unless a new policy approach is adopted.

Given the significant slowdown in economic growth, job destruction has not been as severe as could have been feared (Eurofound, 2012a). This suggests that enterprises may have been retaining staff in the hope that economic conditions will improve. However, if these expectations do not materialize, job retention practices may become unsustainable, thereby leading to significant job losses and higher unemployment.

It is estimated that if there are no changes in policy direction, up to 4.5 million jobs could thus be lost (figure 4). This estimate results from a comparison between actual and potential labour productivity. The fact that actual labour productivity lies below long-term values is interpreted as evidence of job retention.

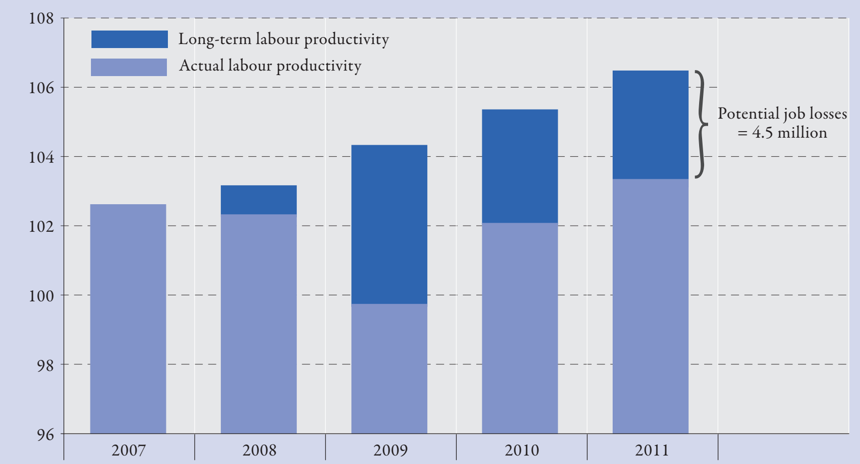
There is therefore urgent need to speed up economic growth. Moreover, specific measures are needed to ensure that faster growth is associated with higher employment. Following the milder recession in the early 1990s, it took five years for employment in the EU to return to pre-recession levels, and the lag varied considerably across countries, underlining the role of labour market policies.

The risks from inaction are becoming unbearably high.

In short, all evidence points to the risk of a prolonged labour market recession. Over one-third of working-age people are either unemployed or excluded from the labour market. Young people and disadvantaged women are particularly at risk.

The result is that citizens' confidence in national governments and European institutions is being eroded and social unrest is on the rise. The window of opportunity for addressing the societal effects of the crisis and regaining the trust and support of workers and enterprises is beginning to close.

Figure 4 Labour productivity (2005 = 100) and potential job losses in the Eurozone



Source: IILS estimates.

2 THE POLICY RESPONSE SO FAR: RATIONALE AND IMPACT

The deterioration in the labour market position of the Eurozone has coincided with a shift in policy stance over the past couple of years. In the majority of the countries, this shift has been towards tighter fiscal policy and labour market reforms – often in the direction of lighter regulation. Already last year, the ILO Director-General in his report to the International Labour Conference warned that such measures had "not contributed to higher levels of investment in the real economy, either in developed economies or in developing countries" (ILC, 2011). And yet, this is the direction in which labour market policies have moved. This section describes these trends and assesses the effects of the measures, including whether they have tackled the underlying factors behind the crisis.

The rise in Eurozone unemployment has gone hand in hand with the tightening of fiscal policy …

In the wake of the global crisis, many countries used fiscal policy as an anti-cyclical device. This strategy was instrumental in creating a floor to the recession and averting the spectre of another Great Depression. Yet, it also contributed to higher fiscal deficits and a build-up of government debt.[1] On average in the Eurozone, government debt increased by almost 15 percentage points in the two years that followed the global crisis. In 2011, government debt represented over 88 per cent of Eurozone GDP and will probably rise further in 2012 (IMF, 2012).

In view of this situation, most Eurozone governments have shifted their policy stance towards a rapid reduction in fiscal deficits – the so-called "austerity" approach. Much of the effort has focused on spending cuts rather than higher revenues. In the Eurozone, government spending as a percentage of GDP decreased by about 2.1 percentage points between the third quarters of 2009 and 2011, while the share of government revenue in GDP increased by 1.1 percentage points during the same period.

[1] The fall in tax revenues as a result of falling labour incomes and lower tax receipts associated with weaker consumption were major contribution to increased deficits.

The reduction in spending by Eurozone governments was mostly accomplished via cuts in government investment, wage bills and welfare benefits. Between 2009 and 2011, each of the three components decreased by the equivalent of around half a percentage point of GDP. The cuts in welfare benefits took different forms. In Belgium, Estonia, France, Greece, Ireland, Italy, the Netherlands and Spain, pension entitlements were reformed. In other cases, unemployment benefits were reduced (as in Ireland and the Netherlands). Entitlements for sick leave were amended in Estonia.

… and labour market reform.

From the outset, governments acknowledged the risk that tighter fiscal policy might derail the incipient recovery. This is why many of them engaged in labour market reform. It was argued that such a policy would boost market confidence and thus business investment, while also supporting long-term economic growth and job creation. Labour market reform was considered as instrumental for promoting employment in the context of a single currency characterized by a low inflation target and tighter fiscal policy. In deficit countries, this strategy would translate into an "internal devaluation", which in turn was supposed to facilitate rebalancing.

Labour market reforms have been adopted in 13 out of 17 Eurozone countries. These reforms have gone in the direction of either a decentralization of collective bargaining or a loosening of employment regulation. Box 1 illustrates some of these reforms.[2] Reforms have generally taken three courses, namely: (i) the decentralization of collective bargaining (in five out of the five Eurozone countries that reformed); (ii) the easing of legal protection against individual dismissals (in nine out of the ten Eurozone countries that reformed); and (iii) the modification of requirements and procedures to be followed in cases of collective dismissal (in four out of the seven Eurozone countries that reformed). Table 1 provides an overview of the direction of the changes in question. Importantly, most of these changes have been carried out with limited social dialogue. The haste and lack of dialogue in recent labour market reforms is a source of concern.

[2] Box 1 draws heavily on Chapter 2 of *World of Work Report 2012* (IILS, 2012).

Box 1 Reforms in collective bargaining and employment regulations in selected Eurozone countries

Over the past couple of years, there has been a tendency to reform the institutions that govern industrial relations and collective bargaining, especially in countries severely hit by the crisis. The following examples illustrate this trend.

- In Greece, Law 3899 introduced in 2010 allows for companies of any size that experience adverse financial and economic conditions to conclude collective agreements containing less favourable conditions than those agreed in the relevant sectoral agreements. These modifications, as well as other reforms, including the reduction of minimum wages in the private sector – contrary to the joint position of Greek employers and worker organizations – were part of the European Commission/ECB/IMF rescue programme.

- In Italy, Law 148 introduced in 2011 allows for company-level agreements to derogate from sectoral agreements and labour legislation on a number of issues, such as wages, working time and dismissal procedures.

- In Slovakia, the parliament modified in December 2010 the measures regulating the extension of collective agreements to non-signatory parties, which now require the consent of the employer as a prior condition for extension. Moreover, a proposed amendment to the Labour Code would introduce limitations on the formation of trade unions, which would now have to demonstrate that they represent at least 30 per cent of the workforce in the company.

- In Spain, the government issued in 2011 a decree (Royal Decree 7/2011) establishing that, in cases of contradictory outcomes at different bargaining levels, company-level agreements would have greater legal validity than sectoral or regional agreements.

The majority of Eurozone countries have changed employment protection legislation for permanent employees, mainly by modifying the regulation of severance pay and notice periods. In some cases, the regulation of individual and/or collective dismissals has been eased.

- In Estonia, a recent reform has reduced severance payments for individual dismissals for economic reasons from 2–4 months to 1 month. Moreover, the grounds for justified dismissal have been broadened, and in cases of unjustified dismissal there is no longer the possibility of reinstatement. Finally, the need for authorization by the labour inspectorate in cases of collective dismissal for economic reasons has been abolished and the principle of priority for rehiring of collectively dismissed workers has been removed.

Box 1 Reforms in collective bargaining and employment regulations in selected Eurozone countries

- In Greece, according to Law 3863 of 2010, the length of the notice period for individual dismissals has been cut from 5 months to 3 months, and severance pay for white-collar workers has been reduced. Also, severance pay can now be made in several instalments. Moreover, in the new legislation, collective dismissals in companies with fewer than 20 employees apply to redundancy of six or more employees (instead of four before the reform). In the case of companies with over 150 employees, collective dismissals now apply to redundancies of over 5 per cent of the workforce (instead of 2 per cent before). Finally, the time limit after which a fixed-term employment contract is automatically considered of indefinite duration has been raised from 2 years to 3 years.

- In Portugal, redundancy pay in cases of collective and individual dismissal for economic reasons and for individual dismissals based on “a worker’s unsuitability” has been reduced to 20 days’ wages – instead of 30 days’ wages before the reform. This change applies only to those contracts concluded after November 2011.

- In Spain, the 2010 and 2012 labour market reforms have comprehensively modified the legislation governing both individual and collective dismissals. For individual dismissals, the notice period in cases of dismissal for objective causes has been halved, from 30 days to 15 days. In the case of unfair individual dismissal, the employee is no longer entitled to the salary accrued during the dismissal process. Compensation in the event of unfair individual dismissal has been reduced from 45 days to 33 days of wages per year of seniority. Finally, in cases of collective dismissal, the time period for consultations between the employer and workers’ representatives has been set to a maximum of 30 days in companies with more than 50 employees and 15 days in smaller companies. These thresholds used to be the minimum time periods for consultation before the reform.

A few countries have reinforced dismissal protection. These include the following cases.

- In France, when a worker who has been collectively dismissed for economic reasons is offered a redeployment outside France the employer is now legally obliged to offer a salary comparable to the current salary for the same position in France.

- In Belgium, the obligation to notify the labour administration in cases of collective dismissal has been reinforced.

- In Slovakia, the European Works Council now has the authority to request to meet with the employer in cases of collective dismissals.

Table 1 **Changes in employment protection regulations and collective bargaining in Eurozone countries, 2008-2012 ***

	Employment protection regulations		Collective bargaining provisions	
	Dismissals of employees on permanent contracts	Dismissals of employees on fixed-term contracts	Collective dismissals	Coordination of bargaining
Countries that reinforced previous legislation	1	2	3	0
Countries that eased previous legislation	9	3	4	5
Total number that reformed previous legislation	10	5	7	5

*Cut-off date is March, 2012.
Source: IILS, based on *World of Work Report* (IILS, 2012).

The shift to austerity may have weakened the incipient and fragile job recovery …

There is growing concern that the Eurozone policy response to the crisis – mainly focused on a combination of fiscal tightening and labour market reforms – may have affected employment while failing to arrest the deterioration in fiscal deficits.

As noted in *World of Work Report 2012*:

> these policies – implemented in a context of limited demand prospects and with the added complication of a banking system in the throes of its "deleveraging" process – are unable to stimulate private investment. The austerity trap has sprung. Austerity has, in fact, resulted in weaker economic growth, increased volatility and a worsening of banks' balance sheets leading to a further contraction of credit, lower investment and, consequently, more job losses.

Recent research by the International Monetary Fund (Ball, Leigh and Loungani, 2011) supports this conclusion. The study suggests that "a fiscal consolidation of 1 percent of GDP reduces inflation-adjusted incomes by about 0.6 per cent and raises the unemployment rate by almost 0.5 percentage point within two years, with some recovery thereafter".

Also, the *World of Work Report 2012* confirms evidence from other studies that labour market reforms will fail to improve short-term employment prospects in the context of limited economic growth. This is because:

> the employment effects of labour market reforms depend heavily on the business cycle. In the face of a recession, less stringent regulation may lead to more redundancies without supporting job creation. Likewise, the weakening of collective bargaining is likely to provoke a downward spiral of wages, thereby delaying recovery further.

The expectation that austerity would boost investment has not materialised. In the first quarter of 2012, Eurozone investment in machinery and equipment represented 6.7 per cent of GDP, nearly one percentage point lower than before the crisis.

… and has not tackled the real weaknesses as regards, first, access to credit by small firms …

In a number of countries, the balance sheets of banks have been affected by the twin effects of risky investments made before the global crisis and increased risk premia on government debt. Banks' efforts to restore solvency have resulted in a large contraction in bank lending, thereby further affecting the economy. The volume of credit to non-financial enterprises decreased by over 200 billion euros in 2009/2010. After some improvement in credit conditions before September 2011, the volume of credit to non-financial enterprises has fallen again by 55 billion euros.

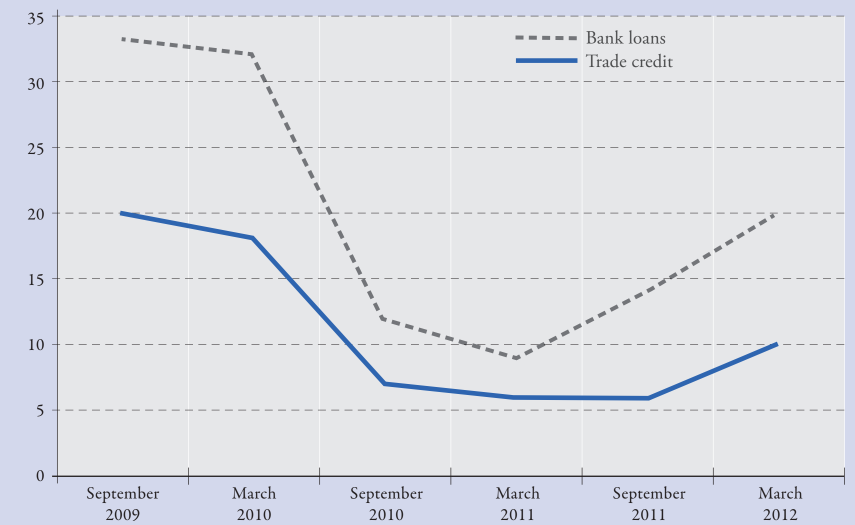
The contraction of bank credit is a major, untackled factor behind the rise in unemployment. Small and medium-sized enterprises (SMEs), which typically require bank credit to fund their output and investments, account for over two-thirds of employment in the Eurozone (and more in the most depressed economies). The ECB's survey on the access to finance of SMEs in the Eurozone indicates a considerable worsening in the availability of finance over the period from October 2011 to March 2012 (ECB, 2012). SMEs also perceived a further deterioration in the availability of bank loans, bank overdrafts and trade credit (figure 5).

Furthermore, 34 per cent of the SMEs pointed to a lower willingness of banks to provide a loan as compared to six months before, whereas only 11 per cent perceived an improvement, a situation close to that perceived by SMEs in 2009, immediately after the bankruptcy of Lehman Brothers. The percentage of SMEs reporting no obstacles to receiving financing was only 8 per cent in Greece, 15 per cent in Portugal, 16 per cent in Spain and 18 per cent in Ireland, compared with 58 per cent in Germany and 56 per cent in Austria.

In general, studies have found that finance-constrained firms tend to hold excess cash to ensure their long-term survival during adverse economic periods. The trade-off of such behaviour is that these firms forego investments that could conceivably reap a higher return. The reluctance of these firms to invest is evidenced by their sizable holdings of liquid assets (table 2). Firms have tended to reduce their investment effort (measured as the value of a firm's investments as a percentage of its liquid assets).

More fundamentally, investment has become more volatile, thereby affecting the predictability of the production and employment horizon (IILS, 2012). More volatile investment not only robs the economy of the stimulus necessary to increase job creation, but also limits the overall quality of the jobs created.

Figure 5 Eurozone SMEs reporting a deterioration in access to finance (percentages)



Note: The figure shows the percentage of SMEs reporting a deterioration in access to finance (bank loans or trade credit) minus the percentage of small firms reporting an improvement.
Source: IILS estimates based on ECB (2012).

… second, persistent intra-zone differences in competitiveness …

The impact of the crisis on the Eurozone has been magnified by differences in competitiveness among its countries. Over the period 2000 to 2008, unit labour costs have remained constant in Germany and increased by about 25 per cent in Italy, Cyprus, Slovakia and Malta, 30 per cent in Greece and

Table 2 Investment as a percentage of cash holdings of small listed companies

	2003-07	2010	2011	Change between 2010 and 2011
Eurozone	55.8	45.6	43.9	**-1.8**
United States	43.6	25.0	34.8	9.8

Note: Cash holdings include deposits and other monetary assets which can be mobilized quickly. Small listed companies include small- and medium-sized enterprises which are listed in stock markets. Thus, the figure of 43.9 means that, on average in the Eurozone, investment represented 43.9 per cent of cash holdings of small listed companies in 2011. This is a fall by 1.8 percentage points vis-à-vis 2010. By contrast, in small listed companies of the United States, investment as a percentage of cash holdings increased by 9.8 percentage points between2010 and 2011.
Source: IILS estimates based on FactSet Research Systems.

Spain, 40 per cent in Ireland and Slovenia and over 80 per cent in Estonia (figure 6). Diverging trends in unit labour costs have resulted in diverging patterns of international competitiveness: countries with the lowest increase in unit labour costs have also experienced the largest increase in their share of total exports from the Eurozone.

In the years following the crisis (2008 to 2011), these differences were reduced, but only partially. Unit labour costs decreased in absolute terms in Ireland (-12 per cent), Estonia (-3.5 per cent) and Spain (-3.2 per cent), and relative to Germany in Portugal (-5 per cent), Greece (-3.4 per cent), Italy (-1.2 per cent), Slovakia (-0.9 per cent) and the Netherlands (-0.8). These improvements have resulted in an increase in the share of the Eurozone total exports for Spain, Slovakia, the Netherlands and Greece and, to a lesser extent, Estonia and Portugal.

Although unit labour costs significantly affect international competitiveness and exports, it is apparent that they are not the only determinant. Italy and the Netherlands, for instance, show a similar increase in unit labour costs, but different changes in exports, which increased in the Netherlands but remained constant in Italy. A similar pattern can be observed for Germany and France and for Finland and Cyprus.

Indeed, price differences among the Eurozone countries have continued to rise after 2008, despite the partial reduction in differences in unit labour costs. Over the period 2010-early 2012, industrial prices in Greece, Italy and Portugal grew much faster than in Germany.

This evidence suggests that an increase in competitiveness is unlikely to be achieved in a short period of time, and that lengthy structural reforms are required to increase productivity. Attempts to reduce unit labour costs by cutting wages would result in a decrease in domestic demand, with only limited effects on exports.

Figure 6 **Change in unit labour costs** (cumulative change over 2000-08 and 2008-11, percentages)

Source: IILS estimates based on Eurostat.

... and third, insufficient focus on labour market policies.

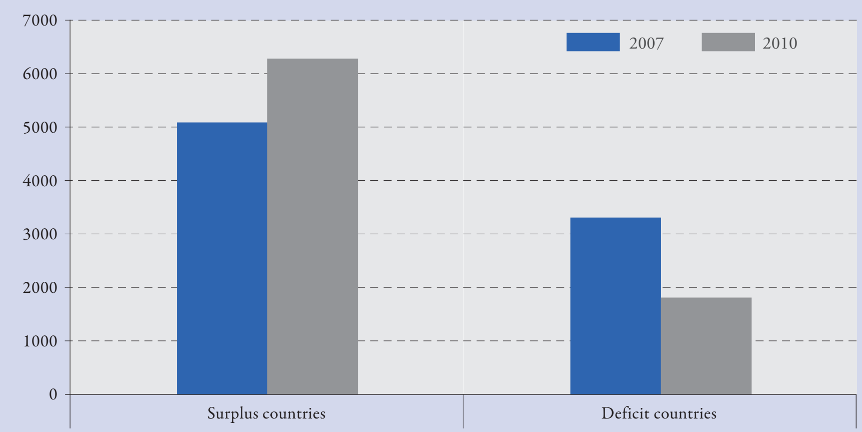
A prolonged recession is typically associated with growing long-term unemployment. Labour market policies, if effective, can reduce the risk of demoralization and labour market exclusion of long-term unemployed workers. They are also key for preparing for the recovery; for example, by providing retraining and upgrading skills. Support of this nature is at the core of a competitiveness strategy.

Yet, spending on active labour market policies – measured per unemployed person – has tended to decrease in recession-hit Eurozone countries (figure 7). The opposite holds true in relatively better off countries.

There is more awareness recently on the need for a policy change.

In April 2012, the EU adopted a comprehensive Employment Package for a job-rich recovery. In presenting the package to the EU Employment Committee, the Commissioner for Employment, Social Affairs and Inclusion, Mr László Andor, indicated that, "As the ILO emphasised … in its *World of Work Report 2012*, the employment slowdown we face is not a normal one. … To move away from this 'austerity trap', we need an alternative approach, a jobs-centred approach".

Figure 7 **Spending on active labour market programmes per unemployed person in surplus countries and deficit countries** (in euros)



Note: Surplus countries refer to Austria, Belgium, Finland, France, Germany, Luxembourg and the Netherlands. Deficit countries include Greece, Ireland, Italy, Portugal and Spain.
Source: IILS estimates based on OECD and Eurostat.

The Employment Package includes the following actions:

- Creating the right conditions for job creation and labour demand, such as hiring subsidies that create new jobs, a (budget neutral) tax shift from labour to environmental taxes or support for self-employment.
- Establishing decent and sustainable wages and avoiding low-wage traps.
- Ensuring appropriate contractual arrangements to prevent the excessive use of non-standard ones.
- Stimulating internal flexibility to reduce job insecurity and fiscal costs.
- Investment in skills and in areas with job potential for the future, notably the green economy, health services and new technology.

The Employment Package also aims to create a genuine EU labour market by improving the portability of pensions, the tax treatment of cross-border workers and awareness of rights and obligations, and the export of unemployment benefits for jobseekers in another country (for a period of up to 6 months).

Furthermore, the Employment Package policy communication underlines the need for a stronger employment and social dimension to EU governance and lays down ways to involve employer and worker representatives in setting EU priorities. This includes the setting up of a "tripartite format" for monitoring and discussing wage developments. Finally, the Package stresses the important link between policy and EU financial instruments (such as the European Social Fund) in supporting countries' employment priorities and reforms.

3 WAY FORWARD

On present trends, there is a risk that tensions within the Eurozone exacerbate. This would have serious negative employment consequences in the short term, for both surplus countries and their deficit counterparts (table 3). Such a damaging outcome can be avoided. Simulations developed for the purposes of this study show that a coordinated job-centred strategy would improve the employment outlook and, provided that reforms are sustained, pave the way for decent work opportunities in the longer term (Box 2).

A job-centred approach includes, first, restoring credit flows to businesses, especially smaller ones...

The job-centred strategy suggested above would address the key sources of the crisis identified in the previous section. It would therefore, first, ease the double constraint on the banks' capability to borrow in private capital markets and to lend to non-financial enterprises. This is crucial: if credit

Table 3 **Unemployment rates in 2012 and 2014: A job-centred scenario versus exacerbated financial stress**

	2012	2014
Baseline		
Total Eurozone	11.0	11.5
Surplus Eurozone countries	7.4	8.0
Deficit Eurozone countries	16.3	16.6
Exacerbated financial stress		
Total Eurozone	11.0	17.3
Surplus Eurozone countries	7.4	12.2
Deficit Eurozone countries	16.3	25.2
Shift to job-centred policies		
Total Eurozone	11.0	9.9
Surplus Eurozone countries	7.4	6.5
Deficit Eurozone countries	16.3	15.1

Note: Surplus Eurozone countries include Austria, Belgium, Finland, France, Germany, Luxembourg and the Netherlands. Deficit Eurozone countries include Greece, Ireland, Italy, Portugal and Spain. The "exacerbated financial stress" scenario is based on ING growth projections, to which the ILO Trends Econometrics is applied in order to derive the unemployment figures. The "job-centred policies" scenario is the outcome of a simulation of the IILS Global Economic Linkages (GEL) model. The figures for 2014 are not projections and are meant for illustrative purposes of the direction of change associated with different policy options. For a detailed explanation of these simulations, see box 2.

Source: ILO Trends for the Baseline and "exacerbated financial stress" scenario; and International Institute for Labour Studies, GEL model, for the "job-centred policies" scenario.

Box 2 **Exacerbated financial stress in the Eurozone versus a job-centred strategy: A modelling assessment**

The sovereign debt crisis in the Eurozone reflects not only excessive indebtedness of certain member states but also the limitations of Eurozone institutions to address imbalances. In particular, since the creation of the Euro, governments can no longer issue debt in a "currency in which they have full control" (De Grauwe, 2011). The link that traditionally exists between sovereign debt and money has thus been cut. In addition, Eurozone institutions have been unable to address so far the diverging trends in competitiveness between surplus countries and their deficit counterparts. Estimates by ILO Global Employment Trends show that a fragmentation of the Eurozone ("exacerbated financial stress" scenario) could lead to significant job losses in both surplus and deficit countries. By contrast, simulations based on the IILS Global Economic Linkages (GEL) model show that a job-centred approach, encompassing the strengthening of Eurozone institutions, would ease adjustment and pave the way for job recovery.

Employment under the baseline scenario

The baseline scenario is based on ILO Trends Econometric Models. Under this scenario, the unemployment rate in the Eurozone would peak in 2014 at 11.5 per cent.

Employment impact of exacerbated financial stress

This scenario is based on a contraction of GDP of -8.1 per cent in 2013, which according to ING forecasts would arise in the event of Eurozone fragmentation (ING, 2011). The return to national currencies would indeed lead to an immediate exchange rate depreciation in deficit countries and a pronounced appreciation in those surplus countries considered to be safe havens. This would entail a significant loss of competitiveness. Financial losses for surplus countries would build up while trade linkages within the Eurozone's main global trading partners would amplify the stress for the real economy. Deficit countries would face rapid declines in their living standards as the external value of their new currency would depreciate.

A severe fragmentation of the Eurozone is expected to raise unemployment rate above 17 per cent in 2014. The unemployment rate would rise in the deficit countries, but also in their surplus counterparts.

Box 2 **Exacerbated financial stress in the Eurozone versus a job-centred strategy: A modelling assessment**

The alternative scenario: A job-centred strategy

The alternative scenario looks at the effects of a strategy inspired by the Global Jobs Pact, i.e. the decent work agenda at times of crisis. Although such an agenda encompasses a large variety of tools and policy actions, numerical simulations can only be performed on a restricted set of instruments. For simplicity, the ILO scenario is here defined as a combination of (i) infrastructure investment equivalent to 1 percentage point increase in the public investment to GDP ratio[3] and (ii) a rebalancing of the share of labour incomes in total income corresponding to an increase in the share of labour income in total income by 1.8 percentage points.[4]

The component of infrastructure spending intends to capture the aggregate demand effect of public spending as well as the productivity-enhancing effect for the private sector of well designed public investment. Infrastructure investment plays the role of a positive externality on firms, since public capital is an input in the production function of firms. This measure captures the set of instruments advocated by the ILO to support enterprises. The stabilization of labour share in total income captures efforts aimed at achieving a more balanced income distribution.

These policies are especially relevant given the relative inefficiency of monetary policy in the current deflationary environment that prevails in most advanced economies: monetary authorities face a liquidity trap as they are left with little room to further reduce interest rates to stimulate investment.

The employment effects of both scenarios are shown in table 3. Exacerbated financial stress would induce a recession in both surplus and deficit countries. However, the recession is much worse and longer lasting in deficit countries than in surplus countries. In the job-centred scenario, output and employment recover and unemployment rates fall in both surplus and deficit countries. The job-centred scenario, however, requires a degree of policy coordination in the Eurozone which is difficult to achieve, especially in view of the different starting positions of Eurozone countries.

[3] The 1 percentage point increase takes place on impact. Spending then gradually declines at a rate of 10 per cent per quarter during the simulation period until they return to their starting value. The stimulus is thus somewhat less than envisaged in the recently-announced EU growth package, but lasts over a longer time period.

[4] This experiment relies on the assumption that this policy mix is undertaken jointly by all countries and that no country engages in strategic games leading to free riding behaviour. The size of the simulated increase in the labour share is in line with what would be needed to restore labour shares to their level at the start of the Euro.

channels were restored and the ratio of investment to GDP was brought back to its pre-crisis level, around two-thirds of the jobs lost since the start of the crisis would be recovered.[5]

In December 2011, the European Banking Authority (EBA) estimated that European banks need about 114.5 billion euros in additional capital in order to withstand a range of shocks. The Capital Plan adopted by the EBA required the banks included in the sample to strengthen their capital base in order to face potential losses from their investments. The goal was to reach a capital ratio of 9 per cent by the end of June 2012. In the EBA's own estimates, however, the effect of the Capital Plan would be to reduce lending into the real economy. Given the strong dependence on bank credit of small firms, which are the main providers of jobs, the goal of leaving banks to their own devices to raise capital adequacy quickly has slowed job recovery.

Instead, there is a case for moving towards a banking union, as this would help to dispel the uncertainty about banks' solvency and to ease the trade-off between reserves and loans. Some conditions, however, are to be met. To start with, shareholders of ailing banks – which have prime responsibility for the toxic practices that prevailed and generated large dividends in good times – and large bondholders would share any losses. This is all the more important because bank restructuring will inevitably lead to increased public liabilities. Moreover, the European Stability Mechanism would perform rescue functions directly with banks – instead of indirectly via support to national governments (which tends to aggravate risk premium on sovereign debt). And, a banking union would entail supervision responsibilities at the Eurozone level. The reform should include a central supervision of the banks by the European Central Bank coupled with a Eurozone deposit guarantee fund.

Second, in addition to addressing bank solvency issues, a specific focus on financing small firms would help kick-start job creation. As noted in the latest annual report of the Bank for International Settlements, large firms have retained access to capital markets (BIS, 2012). By contrast small firms have been squeezed by the credit crunch. The credit squeeze is unprecedented

[5] This estimate arises from two assumptions. First, repairing credit channels in credit-constrained countries (basically deficit countries) would boost investment by small firms to the same extent as has been the case in surplus economies since 2010. Second, in line with what happened in past recovery periods, an increase in investment equivalent to 1 per cent of GDP has been associated with an additional 1.4 million net new jobs in the Eurozone as a whole over a period of around two years .

since the start of the Euro. The difficulties for small enterprises to access bank credit are likely to persist even if the solvency of the bank system improves. The refinancing operations put in place recently by the European Central Bank mostly resulted in higher lending to the governments and seem even to have reduced lending to the private sectors. As small firms rely entirely on bank credit for financing their investment, it is important to reinforce credit channels to sustainable small enterprises. These measures would represent a powerful leverage for job creation as SMEs account for over two-thirds of total employment in the Eurozone.

This can take the form of the reinforcement or creation of credit institutions geared towards small firms. Another approach would be the strengthening of guarantees of credit lines provided to small firms by existing banks, to help SMEs overcome their aversion to risk in the current weak economic environment, as happens in Germany. Access by small firms to the financial instrument provided by the EU Competitiveness and Innovation Framework Programme for 2007-13 could also be facilitated. This applies, in particular, for the High Growth and Innovative SME Facility (GIF), which provides venture capital, and the SME Guarantee Facility (SMEG), which guarantees portfolios of microloans and larger loans.

Third, new regulations to prevent any recurrence of past inappropriate practices are also called for. This means reinforcing prudential control at the Eurozone level, addressing excessive risk taking and remuneration practices not linked to the performance of the sector, clarifying responsibilities for the current state of some banks and taking action as needed, and ensuring that banks focus on their original intermediary role instead of developing own-account activities. Recent proposals by the European Commission in this direction are a much welcomed step.

... second, addressing competitiveness issues while promoting growth ...

As noted in the previous section, deflationary policies have failed to tackle competitiveness problems within the Eurozone. Instead, it is important to devise an approach which addresses the imbalances while promoting growth. In June 2012, the International Labour Conference adopted a Resolution on youth employment that contains a strong call for action to tackle the youth employment crisis (box 3). The Resolution provides guiding principles to shape the policy mix appropriate to each country.

Deficit Eurozone economies suffer from low capital stock and low productivity. Spurring investment, therefore, should be the main policy tool to increase productivity and improve competitiveness. This would complement the efforts carried out so far to reduce unit labour costs via wage moderation only. Investments in human capital, infrastructure and renewable energy are needed to achieve this objective. Government subsidies or

Box 3 Tackling the youth employment crisis: A call for action

In June 2012, the International Labour Conference adopted a Resolution on youth employment that contains a strong call for action to tackle the youth employment crisis.

A multi-pronged approach geared to pro-employment growth and decent job creation is required to reverse the negative trends of youth labour markets. In this respect, the Resolution provides a blueprint for shaping national strategies and action on youth employment, as well as guidance to member States for the review of existing policies or for crafting new policies leading to more decent jobs for youth.

Although the policy mix is highly dependent on country situations, the Resolution provides guidance on five policy areas: (i) employment and economic policies to increase aggregate demand and improve access to finance; (ii) education and training to ease the school-to-work transition; (iii) labour market policies to target employment of disadvantaged youth; (iv) entrepreneurship and self-employment to assist young aspiring entrepreneurs; and (v) labour rights to make sure that young people receive equal treatment and are afforded rights at work.

The 185 member States of the ILO agreed that addressing the youth employment challenge requires broad-based partnerships at national and local levels, involving governments, employer organizations, trade unions and other actors. At international and regional levels, the ILO should provide global leadership within the multilateral system to assist countries to take immediate and targeted action in support of decent work for youth.

Source: International Labour Conference, 2012a.

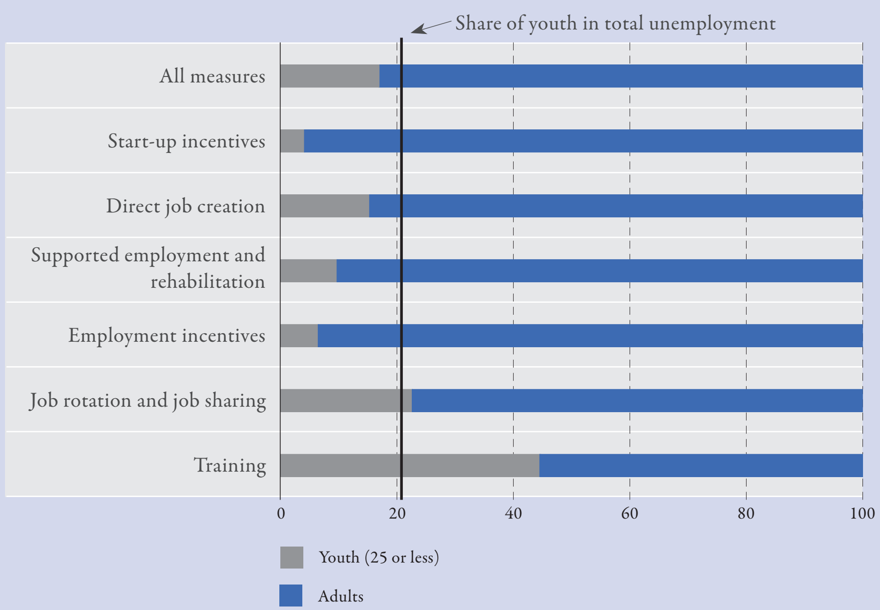
direct investment can act as a catalyser of private investment and bring these countries onto a path of higher output and productivity growth. The creation or strengthening of investment banks could be strategic in this respect. In some countries such as Greece, improved competitiveness also requires an improvement in the quality of public administration.

On the other hand, there is scope in surplus economies to compensate for the lower demand arising from deficit countries. By letting wages grow in line with productivity (and no less as was the case hitherto), these countries would at the same time boost their own growth and job creation prospects and facilitate intra-Eurozone adjustment.

... notably through renewed emphasis on employment policies and a youth activation guarantee ...

Fiscal austerity alone would not be sufficient to restore confidence in the Eurozone. In fact, austerity has resulted in lower growth and employment,

Figure 8 Participants in active labour market programmes in Eurozone countries by age group, 2010 (percentages)



Source: IILS estimates based on OECD and Eurostat.

which has worsened investors' expectations and is thus prolonging and deepening the crisis. In the same way, ill-conceived reforms of labour markets and social protection, such as the suspension of collective bargaining have not encouraged or facilitated a recovery in employment.

Rather, what is urgently needed is a renewed emphasis on employment policies. The ILO Global Jobs Pact (ILC, 2009) provides a set of balanced and realistic policy measures that countries, with the support of regional and multilateral institutions, can adopt to ease the impact of the crisis and accelerate recovery in employment. Employment policies are particularly needed for youth, who have been disproportionately affected by the global crisis – developments which have exacerbated earlier challenges. There is growing concern that the situation facing youth has become unsustainable and threatens to erode further social cohesion. Moreover, if nothing is done, there will be severe negative consequences on growth prospects as a result of reduced labour supply and increased future skill mismatches. This would only delay further any recovery. Such a scenario would also have important long-term negative consequences on youth themselves in terms of reduced future earnings and the negative stigma associated with being inactive or detached from the labour market for an extended period. To make matters worse, youth are under-represented in the vast majority of active labour market programmes (figure 8).

In a number of Eurozone countries, like Austria, Belgium and the Netherlands, new training programmes have tried to favour the school-to work transition and to ensure young women and men remain attached to the labour market. In other instances, the launch – or continued support – of special programmes for youth unemployment, along the line of the youth activation guarantee has taken precedence. Under such guarantees, the government commits itself to offer young people in a defined target group – unemployed, not in education or with a short employment experience – a place in an education, training or work programme.

Box 4 **Examples of youth guarantee programmes**

Sweden: the case of a personalized youth guarantee programme
Following a period of unsuccessful job search, all young people in Sweden are offered youth specific activities within the "Job guarantee for young people". The programme aims to provide special measures and activities for the participant to enable them to get a job or return to education as soon as possible.

To be eligible, youth aged 18 to 24 need to be registered with the Public Employment Service (PES). After 90 days of unemployment, the young jobseeker is referred to a programme for a period of four months. During the first three months, the activities of the job guarantee include an in-depth assessment, educational and vocational guidance and job search activities with coaching. Thereafter, these activities are combined with work experience, education and training, grants to business start-ups and employability rehabilitation efforts.

During the in-depth assessment it is also decided whether the participant's needs can best be met by the Employment Office or with an external complementary provider. A young person can participate in the job guarantee for up to 15 months.

The cost of the job guarantee in 2010 was less than 6,000 euros per participant. It is estimated that 46 per cent of the young jobseekers had successful outcomes as a result of the guarantee.

Finland: the case of effective and speedy interventions in support of youth
In Finland, the youth guarantee scheme was established in 2005 and revised in 2010. The project targets young people below age 25 who are finishing school and do not have a job or a place in an education programme. From 2013, however, the programme will be expanded to young graduates under age 30.

The Finnish programme shares the aim of the Swedish one – to bring unemployed and inactive youth back to employment – and has also the PES at the centre of the implementation of the scheme. More specifically, it includes a personal development plan which is set up within the first three months of unemployment. Within this time, the registered youth has to be offered a job, a place in either academic education or vocational training, or any other activation measure deemed necessary to improve job prospects. The difference with the Swedish system is the speed of intervention. In Finland, intervention under the youth guarantee occurs immediately when the youth registers as unemployed and before a maximum period of three months each youth has to be placed in either a job or education.

Evaluations suggest that the programme has succeeded in reducing youth unemployment and inactivity. The success rate was estimated by the PES at 79.2 per cent in 2010 and 83.5 per cent in 2011. This was possible due in part to a budget increase in 2010 that allowed the PES to increase the number of advisers and reduce the waiting period for young people benefiting from an intervention.

Source: Eurofound (2012b) and European Monitoring Centre on Change (2012).

Seven European Union countries have introduced youth guarantees, namely Austria, Denmark, Germany, the Netherlands, Norway, Poland and Sweden (box 4). Portugal has also recently introduced a similar measure, the "Impulso Jovem". Some countries have a more complete approach in which young women and men are offered the right to an education, training or a job depending on their specific characteristics and needs. In Denmark for example a range of policies exist – guidance, introductory courses or bridge-building schemes – with individuel client-specific support determined by age and education.

Other countries outside the European Union have also put in place youth guarantees programmes, which in some instances were reinforced in 2011. Australia and New Zealand focus more on enhancing educational attainment with a view to improving future employability of young people (as opposed to quick labour market (re)integration). In New Zealand, for example, the objective of the Youth Guarantee initiative is to improve transitions between school, tertiary education and work. This is achieved by providing improved access to study to 16- and 17-year-olds not currently engaged in education.

In terms of what actually works, the relatively long experience of Nordic countries offers some important lessons[6]:

- Early action tailored to a targeted group: Measures should take effect as soon as the target group becomes unemployed and needs to be tailored to the disadvantage rather than the group per se. In Finland for example, measures are targeted at various youth groups – such as a social guarantee for under 25-year-olds who have been unemployed for over three months.
- Combining programmes and services: It is important for countries to have a wide range of policies from which measures can be combined to enhance effectiveness. Young job seekers represent a heterogeneous group and a one-size-fits-all approach does not work. "Mixed" strategies allow employment services to select the most effective instruments for each client, e.g. by combining training with job search assistance. Youth guarantee programmes in Norway and Sweden are thought to be success-

[6] See Ramböll Management Consulting (2010) for detailed analysis on the effectiveness of youth guarantee programmes in Nordic countries.

ful mainly because these countries count with integrated activities which use job seeking as a starting point, but draw upon other measures if job seeking alone does not work.

- The recently adopted ILO Recommendation on national floors for social protection also provides a key reference in this area (ILC, 2012b).
- The rate of success of the programmes is high. Despite the crisis, the proportion of the young unemployed involved in the programme who found a job was 46% in Sweden in 2010 and over 80 per cent in Finland in 2011.

Implementing such a young guarantee programme across the Eurozone would not exceed 21 billion euros (table 4) – which represents around 0.45 per cent of Eurozone government spending, a modest figure vis-à-vis expected benefits. This includes 16.6 billion euros of spending in the programme itself and the remaining 4.3 billion euros to cover the cost necessary to ensure that Public Employment Services are adequately staffed so as to effectively implement the programme.

Table 4 **Cost and allocations of a youth guarantee scheme in Eurozone**
(million of euro)

	Cost of youth guarantee programme without administrative costs	Public employment services	Total cost
Eurozone	**16,821.9**	**4,264.2**	**21,086.11**
Belgium	372.1	94.3	466.47
Germany	1,395.0	353.6	1,748.63
Estonia	104.6	26.5	131.11
Ireland	347.6	88.1	435.71
Greece	926.4	234.8	1,161.28
Spain	5,617.5	1,424.0	7,041.49
France	2,860.0	725.0	3,585.01
Italy	3,081.2	781.1	3,862.28
Cyprus	49.6	12.6	62.14
Luxembourg	11.7	3.0	14.71
Malta	24.6	6.2	30.84
Netherlands	71.9	18.2	90.08
Austria	184.2	46.7	230.90
Portugal	841.7	213.4	1,055.12
Slovenia	83.4	21.1	104.56
Slovakia	491.0	124.5	615.41
Finland	359.3	91.1	450.36

Note. Programme costs (based upon Swedish example) are estimated at 6,000 euros per unemployed youth plus administrative costs, in terms of resources needed for Public Employment Services to serve the programme, at 600 euros per participant.
Source: IILS estimates.

The job-centred scenario developed above provides an indication of the significant benefits that could be obtained from these policies, provided they are carried out as part of a broader growth strategy.

… and ensuring public employment services are adequately staffed.

Successful delivery of active labour market programmes hinges on having an effective employment service. This is central to the introduction of a youth guarantee scheme as discussed above, but is also key to other programmes and job search support.

Yet, in countries where unemployment is highest, client-to-staff ratios remain elevated, notably in Southern Europe. By contrast, in Germany, a new law states that the ratio of staff to long-term unemployed should be 1 to 75 for jobseekers under age 25, and 1 to 150 for older jobseekers.

Pro-employment programmes can be financed by broadening the tax base.

The large majority of tax revenues weigh on labour, work effort, real investment and innovation. So increasing taxation on these sources is likely to have negative effects on growth and employment. Indirect taxation also tends to be regressive and thus aggravate income inequalities.

In order to avoid these effects, alternative sources of taxation can be explored (IILS, 2011). An exceptional tax on property and capital gains would help collect more revenues and would permit the funding of pro-employment programmes, the reduction of labour taxes or accelerated depreciation allowances for real investment by small firms. In addition, properly-designed taxes on property and capital gains would be progressive and would not entail significant perverse effects on growth and the location of investment.[7]

[7] According to OECD (2010), the decrease in capital gain taxes creates opportunities for tax evasion since it might encourage the tax payers to convert ordinary taxable income into capital gains and to make risky investments for tax reasons.

There is a dual economic rationale underlying the implementation of a financial transactions tax. First, it would help fight excessive short-term speculation in the stock and commodity markets, which produces price volatility, and second, it would allow governments to raise substantial revenue with a relatively low rate since the potential tax revenue would be large. Moreover, the tax would be imposed on a relatively small number of actors, to facilitate its implementation. For instance, a financial tax could be levied on the sum of profits and remuneration of financial institutions. The European Commission (2011a) found that the implementation of a 5 per cent financial tax would generate between 11.1 and 25.9 billion euros in tax revenues, depending on the design. However, the implementation of a financial tax would need to be coordinated with existing regulations across countries, especially for closely integrated markets in order to avoid tax and regulatory arbitrage and at the same time promote a level playing field.

Environmental taxes are generally levied on the consumption of energy and the emission of pollution as a means of discouraging environmentally harmful activities. They also seek to change behaviour by encouraging polluters to develop and adopt cleaner, more efficient technologies, and thus pay a lower tax. In addition, environmental taxes provide a means to shift the tax burden from labour to the users of natural resources. Although the tax in this sense is revenue neutral, it generates additional revenues through an increase in the tax base, which makes it possible to reduce taxes on income and social security contributions. The result is therefore a double dividend, as the tax has a positive effect on both the environment and employment.

Any tax reform will not achieve its potential unless tax compliance and regulation are strengthened and coordinated across countries. Countries around the world are now attempting to implement stricter rules for tax compliance and are initiating international tax information exchange in view of increasing revenue. These are important steps for improving the transparency of the system. In April 2012, the European parliament adopted a Common Consolidated Corporate Tax Base, which aims to harmonize the calculation of taxable incomes in the EU. The Commission estimates that such an agreement would reduce compliance costs by two-thirds and boost economic growth.

4 CONCLUDING REMARKS: NO RECOVERY POSSIBLE WITHOUT CONCERTED ACTION

Coordination is key among Eurozone countries …

The current crisis has made clear that in a globalized world economic shocks ignore national borders and that economic imbalances in one country are easily spread to the whole Eurozone and beyond. Restoring confidence requires that the Eurozone members coordinate their policies in relation to income, productivity, taxation and investment. Furthermore, it is essential that the risk arising from onerous sovereign debts and the insolvency of banks is shared among countries and guaranteed by the reinforcement of the relevant Eurozone and wider EU institutions and instruments.

The European Investment Bank (EIB) could strengthen its support to investments in activities with a high and rapid economic multiplier, such as energy and transport infrastructure. Investment opportunities in sectors in which EU companies hold strong competitive positions such as biotechnology, environmental equipment and high speed transportation exist and would benefit from an EU-wide industrial policy. The EIB operational activities increased by 65 per cent to counteract the effects of the crisis but they have fallen back to their pre-crisis level in 2012.

The employment effects of EIB-funded investment could also be increased through the inclusion of clauses similar to those currently in place in relation to the environment. Thus, EIB loans would be allocated depending on the estimated employment intensity of the investment plans, notably in depressed areas. The creation of project bonds to fund employment intensive investment would be an interesting option in this respect.

Eurozone initiatives to boost the investors' confidence in the financial system, like the European Banks Coordination "Vienna" Initiatives, could also be developed. The European Bank Coordination Initiative successfully helped to preserve financial sector stability in emerging European countries at the height of the global financial crisis. Similar initiatives

Box 5 Sweden's response to the financial crisis in the 1990s: Lessons from a job-centred strategy

The situation faced by Sweden in the early 1990s shares similarities with the current crisis: the burst of a real estate bubble which had been fed by deregulation in financial markets, a deterioration in banks' balance sheets and a dramatic fall in economic activity. Indeed, Sweden experienced a severe recession at the beginning of the 1990s, with GDP decreasing by around 5 per cent, employment rate falling by almost 10 per cent and unemployment increasing five-fold (see Freeman et. al, 2010).

The government reacted, first, by reassuring depositors and consolidating financial institutions. In order to restore confidence in the Swedish financial sector, the government issued an unlimited guarantee for which no depositors or other counterparts to Swedish financial institutions would suffer any loss. This measure had the effect of reassuring private depositors while re-establishing credit lines with foreign banks. Moreover, a common framework of measures was developed for rescuing financial institutions with the aim to avoid an excessive burden on government expenditures. Banks demanding public support had an obligation to provide full disclosure of their financial positions, opening their books to full scrutiny. This allowed testing the medium term bank profitability in order to provide financial support only to those institutions that were assessed as being worth rescuing. In addition, shareholders were not covered by the government guarantee and were exposed to the risk of capital losses to the same degree as the government. These measures limited the risk of moral hazard by reducing the incentives for banks to demand financial support from the government and made the cost of the rescue of the financial sector more acceptable to the public opinion.

Second, fiscal policy was accommodating and employment programmes were developed to reduce the risk of long-term unemployment and labour market exclusion. The government allowed relevant fiscal deficits to develop during the crisis in order to avoid a contraction of the national welfare system that would have deepened the impact of the crisis on workers' living conditions and domestic demand. This also included renewed emphasis in employment programmes and active labour market policies. It led to the creation of a youth employment guarantee, as described in section 3.

Third, social dialogue was maintained. Social partners did not abandon the coordination of wage bargaining at the national level. This allowed setting wage increases in line with the need to secure international competitiveness to the manufacturing industry.

Finally, the Swedish currency depreciated which also supported recovery. Exports as a share of GDP doubled between 1992 and 2008.

The result was a relatively quick economic and job recovery from the financial crisis, at a relatively modest cost to the public purse. Some estimates put the final costs of financial rescue measures at 3 per cent of GDP, instead of 4-to-5 per cent as originally feared (Jonung, 2009).

These policies could be used as a source of inspiration for addressing the Eurozone crisis. True, the currency instrument cannot be replicated and, in the early 1990s, Sweden could benefit from a more dynamic external environment than is the case today.[8] However other elements of the strategy remain relevant and indeed timely.

[8] The role of currency depreciation should not be over-estimated. For instance, despite a significant depreciation of its currency, the United Kingdom continues to face a fragile recovery.

at the Eurozone level would avoid the emergence of uncoordinated and competing policy responses in closely integrated financial markets. In the absence of coordination, excessive and disorderly deleveraging may be the outcome.

Finally, the objectives of the European Structural Funds could also be reassessed against the objective to boost employment, especially in deficit countries. Given the institutional setting of the programme, its reorientation may be too lengthy to produce immediate effects but it could be regarded as a strategic tool to overcome competitiveness imbalances among Eurozone countries in the medium term.

… between Eurozone and other global players …

There is a significant risk of contagion of Eurozone problems and job prospects in other parts of the world. Besides the necessary coordinated initiatives needed at the Eurozone level, it is crucial to ensure that major non-Eurozone global players contribute to the job-friendly recovery. In particular, large emerging economies which have continued to rely on exports to advanced economies as drivers of development need to rebalance growth. Ensuring that labour incomes grow in line with productivity, boosting investment in the rural sectors and building solid social protection, consistent with their economic possibilities, would help. The ILO's Recommendation on social protection floors represents a major benchmark in this respect. Stepping up efforts to implement core labour standards would also help rebalance growth and achieve more equitable outcomes in all countries. There is therefore a strong case for concerted global action.

…and among social partners.

The depth of the adjustments required to exit the crisis is such that any policy strategy needs to have the support of all social partners in order to be credible. In this respect, social dialogue is not only a tool to ensure an equitable distribution of the efforts necessary for the recovery but also a key "collateral" for innovation and investment. Social dialogue has also a key role to play in monitoring policies and their outcomes, alert on emerging issues and keeping employment at the core of the policy attention.

Importantly, Sweden overcame the financial crisis of the early 1990s through a combination of supportive macroeconomic policy, well-designed employment programmes along the lines described in the preceding section and social dialogue (box 5).

The effective implementation of the EU Employment Package will require coordinated and coherent actions and initiatives by EU institutions, Member states and social partners. It will also have to be fully part of the new regular system of EU economic governance and its national implementation. A job-centred and growth-oriented approach should also be better reflected in the EC-ECB-IMF assistance packages to Eurozone countries. The European Parliament has highlighted both in its 2011 Resolution on responding to the financial, economic and social crisis and in the 2012 Annual Growth Survey that the ILO should be involved in the EC-ECB-IMF assistance packages.

The EU social partners have agreed in April 2012 on a joint work programme for 2012-2014 in the context of responding to the employment crisis and EU economic governance. The EU action on job-rich recovery, inclusive growth and socially responsible fiscal consolidation could benefit significantly of an active interplay between social partners and public authorities at all relevant levels.

Such an integrated and coherent approach can contribute to the realization in times of crisis of the EU Treaty objectives on sustainable development based on balanced economic growth and price stability, a competitive economy aiming at full employment and social progress. It can also contribute to the realization of the EU Treaty horizontal social clause (box 5), on promotion of social dialogue and of the rights and principles guaranteed by the EU Charter on Fundamental Rights, by the conventions of the Council of Europe and by ILO international labour conventions that are widely ratified by Eurozone countries.

Box 6 The EU Horizontal Social Clause

The horizontal social clause is one of the general provisions inserted into the EU legal framework by the Treaty of Lisbon, aiming to ensure policy coherence regarding social issues at the EU level. Enshrined in Article 9 of the Treaty on the Functioning of the European Union, it requires the EU to take into consideration a number of social requirements when "defining and implementing its policies and activities". These requirements encompass:

- "the promotion of a high level of employment";
- "the guarantee of adequate social protection";
- "the fight against social exclusion";
- "a high level of education and training"; and
- "a high level of protection of human health".

While not transferring any new competences to the EU, the Horizontal Social Clause requires the EU's institutions to strike an appropriate balance between social concerns and other policy goals. This entails an obligation for the EU and its Member States to apply this clause in relation to any EU policy and actions. Thereby, the EU treaty framework also provides a legal basis for assessing the social impact of EU policies (European Economic and Social Committee, 2012).

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