Quo Vadis, EU? An Inquiry into the Dysfunctional Nature of the EU's Labour Market

Sabrina Schönfeld
Juior Sophister

In this essay, Sabrina Schoenfeld questions whether the alarming fissures in the EU labour market are a result of deep structural flaws in the economic orthodoxy. Three pertinent labour issues are raised, and taken together they provide strong evidence challenging the belief that private demand can fuel economic growth perpetually. She concludes by warning that these inherent flaws must be acknowledged in order to develop an optimal strategy for the future.

"The errors of a theory are rarely found in what it asserts explicitly; they hide in what it ignores or tacitly assumes."(Kahneman, 2012, pp. 274-275)

Introduction

The labour market of the EU is a unique construct. Assisted by the four freedoms (free movement of people, goods, services and capital), the single market offers a vast range of opportunities for millions of workers. However, the financial and economic crises have put the EU's labour market under severe stress. The Commission's long-run strategy of using labour market flexibility and mobility as the safeguards against the threat of diminishing competitiveness in a globalised world economy requires reassessment, given the devastating consequences of the Great Recession. This essay seeks to provide why these strategies have been unable to cope with the crisis. It is structured as follows. The first part will provide an overview of the mechanics and theoretical assumptions for the functioning of the Union's labour markets. The second part will reveal systemic conflicts, highlighting the need to rethink the economic and social strategy of the EU.

The EU's Labour Market

The general design of the EU's labour market aims to introduce mechanisms that ensure competitiveness. Flexibility is a key requirement, as this can, ideally, compensate demand shocks and balance the natural fluctuations of labour demand. Competitiveness, on the other hand, can be considered not only as an end, but as a means as well. Competition is at the core of current economic thought, working as an incentive for governments to have well designed policies in order to remain competitive and to increase the overall efficiency of the EU's labour market by economic convergence. In this respect, non-wage costs (used to finance social policy) are a key variable determined by each individual state.

Most countries have benefitted considerably from the creation of the single market. Satisfactory overall growth rates in the 1990s and early 2000s ensured a mostly positive impact on the labour statistics of the member states. Although only mediocre convergence in growth and unemployment rates - especially after the Eastern enlargement - highlighted the complexity of the challenges, hopes remained high that a well functioning, competitive single European labour market was achievable in the long run (Cappelen et al., 2003, European Commission, 2006). However, the global financial crisis, starting in 2007, amplified the impact of practical and systemic problems that the project has been struggling with from the beginning.

Although the European labour market was able to withstand the disastrous effects of the financial crisis initially, unemployment skyrocketed to unprecedented heights from 2011 onwards. Despite efforts to stabilise the European economies through bailout programs and structural and labour market reforms[1], the overall performance of the EU's labour market remains a matter of concern. The EU's institutions attribute this to the great variance of the labour markets' structures and inflexible labour markets (European Commission, 2013a, European Commission, 2013b). By 2013, the European labour markets appear to have stabilised, but substantially high long term and youth unemployment rates remain at worrying levels. Reports from the European Commission highlight the dangers of structural problems, as job finding rates in many member states linger at all-time low levels; youth unemployment has hit the 50per cent mark in Spain and Greece, and floats above 25 per cent in most member states (2013b). Fear that these problems may become one of a persistent nature dominates the debate about how to improve the functioning of the individual member states' labour markets (European Commission, 2013a).

Labour force mobility is another cornerstone of the EU's strategy to deal with labour demand fluctuations. In theory, a flexible and mobile workforce can, in part, adjust the disequilibrium of supply and demand. However, in practice, only about 3 per cent of EU citizens are moving to look for jobs within the EU (Dhéret et al., 2013), highlighting the significant disparity between theoretical assumptions and reality. Moreover, language

1. These reforms are at the heart of the Commission's strategy to resolve the unemployment crisis. For example, in late 2013, the Commission reported that, "European countries have shown an increased commitment to tackle the structural weaknesses built-up over the last decade. Substantial reforms, aiming at improving the resilience of the labour market, introducing more internal and external flexibility and facilitating the transition between jobs, have been introduced in several member states, and more are planned in years to come." (2013b, p. 60)

barriers and bureaucratic struggles contribute notably to the mobility inertia. The harmonisation of skills and qualifications throughout the EU remains the mammoth task for the institutions and member states.

While these barriers to mobility certainly are significant, they do not explain the severity of the current malaise. To answer the question at hand, a closer look on the underlying dynamics at play is required. The remainder of the paper will examine three sources responsible for the distortions of the labour market and will propose that these are simply corollaries of systemic flaws at work. It is worth noting, though, that the discussion of sources in this paper is not extensive by any means, but merely puts the focus on the most disruptive forces.

Are Systemic Flaws at the Heart of the Problem?

The Widening Gap between Labour Productivity and Real Wages

A good starting point for this analysis is the oft-discussed decline of trade unions and the resulting loss of labour's bargaining power. Scholars attribute the diminished influence of trade unions to the rise of neoliberalism, the ideology that has shaped the policies of the EU's member states considerably (Harvey, 2005; Flassbeck and Lapavitsas, 2013). Even in countries with relatively strong unions, such as Germany, bargaining power has been on the decline. For example, Germany's trade unions were put under considerable pressure to accept wage moderation in the early 2000s, contributing greatly to the economy's export based boost in the years to follow (Mazier and Petit, 2013). This wage moderation resulted in a desynchronised movement of labour productivity and average income per worker, with a widening gap over time (Flassbeck and Lapavitsas, 2013). However, Germany is not an exception in this regard, as Figure 1 illustrates. Scholars have noted the diminishing collective bargaining power in most western countries - expressed through increased labour productivity and wage growth discrepancies - and its positive relationship with inequality (Machin, 1997, Acemoglu et al., 2001). Others have argued that the weakening or circumventing of labour unions is an imperative necessity for the application of neoliberal theory (Harvey, 2005, Flassbeck and Lapavitsas, 2013).

The conflict between capitalism and labour demands in a democratic regime has been well discussed, and may be conducive to the understanding of the underlying problems of the EU's labour market. Many scholars have identified the mid-1970s as the tipping point when growth, spurred by the post-war period, slowed down and the conflict between capitalism and democracy re-emerged (Reich, 1991, 2010; Streeck, 2011). There is general agreement that inflation can be considered as a manifestation of the inherent conflict between the demands of capitalism and the demands of labour (Galbraith, 1999; Streeck, 2011). During the Bretton Woods regime, fiscal and monetary policy could be used to consolidate democratic and capitalist politics to satisfy both sides' demands to keep distributional inequality in check. The decreasing growth rates in the 1970s - while trade unions still held great power - led to high levels of inflation in the 1970s, as policy-makers faced the trade-off between unemployment and inflation, and opted for the latter. Following this, Volker's tenure as Chairman of the Federal Reserve resulted in a change of policy which brought about deflation, which in turn led to high public debt in the 1980s (Streeck, 2011). Lastly, the credit boom in the 1990s and early 2000s, fuelled by consumers' attempts to compensate for declining incomes, resulted in high private debt, and, eventually, culminated in the outbreak of the financial crisis in 2008 (Reich, 2010, Streeck, 2011).

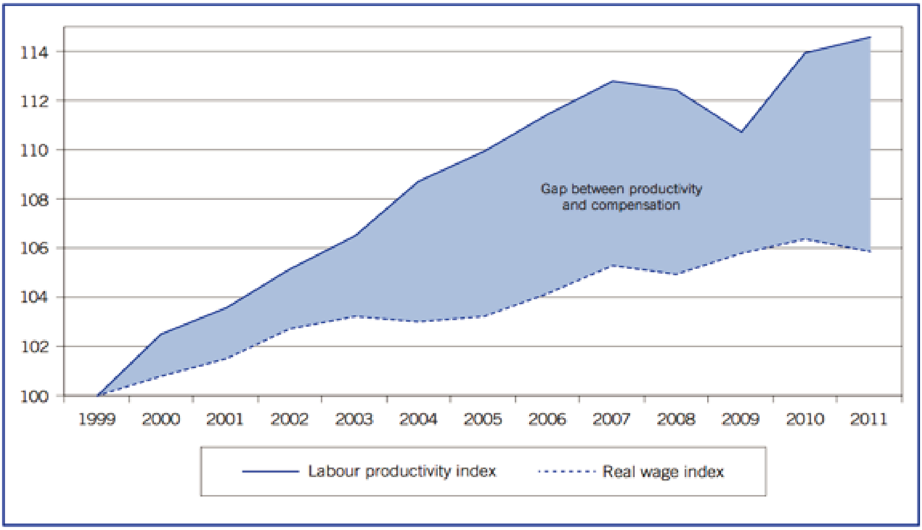

Figure 1: Trends in growth in average wages and labour productivity in developed economies (index: 1999 = 100). Source: International Labour Office, 2013, p. 48

Developed economies, many of who had followed the path described above, took different measures to stabilise economic output and avoid big drops in employment and consumer demand. Since the production of goods and services, above all, ensures economic security for the worker, high economic output remains a crucial necessity. However, an extreme drop in production could not be avoided in the aftermath of the financial crisis. Moreover, countries in the euro area, stripped of the ability to devalue their currency, could only react by devaluing the living standards of their citizens, rather than their currencies, to remain competitive in the global economy. To illustrate this point, in their discussion on the success of 'competitive internal devaluation', Mazier and Petit (2013) noted that, "countries applying such policies [...] run the risk of opening a cumulative process of deterioration.

Austerity policies are all the more ineffective that they are implemented in a group of interdependent countries." (p. 514)

Declining Consumer Spending and Domestic Demand

A second cause of the Great Recession has been attributed to the different growth strategies that the economies had adopted in the run-up to the crash, that are directly linked to the decline in disposable income (International Labour Office, 2013). Export-driven growth had been achieved in some countries through the prior reduction in labour unit costs, resulting in low levels of aggregated demand. Other economies adopted either demand-driven or debt-driven growth strategies. The former, for example France, achieved this by keeping labour productivity and wages in line. The latter, such as the United Kingdom or, outside the EU, the USA, worked following the logic of the mechanisms described in the previous section i.e. by the compensation of declining wages through debt (International Labour Office, 2013).

The current dilemma of the EU is caused by declining or stagnating domestic demand levels in the majority of the member states (Flassbeck and Lapavitsas, 2013; European Commission, 2013a). Domestic demand, consisting not only of household consumption, but government investment, too, has been additionally stifled through austerity measures imposed to balance national budgets. To be sure, a lack of domestic demand is problematic for labour markets for obvious reasons, as low demand for goods and services translates into low demand for labour. Consequently, low domestic demand in too many EU member states and major international trading partners leads to a vicious cycle of low labour demand, low income levels, implying low consumption, resulting in even lower labour demand.

With public finances already subject to the burden of debt as a result of bailout programmes, rising social protection payments, and a steep decline in revenue, the scope for expansionary fiscal policy is limited. From a monetary policy perspective, quantitative easing, conducted by the European Central Bank, has helped to stabilise the financial system, but this mechanism has proven to be inefficacious to stimulate aggregate demand (European Commission, 2013a). The only feasible option for governments in a downturn spiral as described above is further downward pressure on labour costs to minimise unemployment, with simultaneous efforts to create jobs in the export sector, in the hope of gaining ground in the competition for foreign demand and investments.[2] This can, in the short run, lead to an improvement, as the German case has shown. Similarly, low domestic demand can lead to higher exports, as producers allocate more resources to satisfy foreign

2. This is reflected in the current developments within the EU: "[...] the adjustment of internal and external imbalances is continuing. There is evidence that a shift in production factors from non-tradables to tradables sectors is contributing to the reduction of current-account deficits in vulnerable economies." (European Commission, 2013a, p. 3)

demand (Esteves and Rua, 2013). However, warnings have been issued by various organisations that the current strategy of fiscal austerity in combination with the disparity between productivity and real wages in many countries may have disastrous consequences, leading to rising income inequality and a significant impact on labour dynamics, as can already be observed in many EU member states (International Labour Office, 2013). Further research implies that aggregate demand in the eurozone and most EU countries is mainly wage-led, supporting these recommendations (Onaran and Galanis, 2012). Therefore, this strategy cannot be regarded as sustainable in the long run.

The Changing nature of Labour

A third cause of the crisis of the labour market has been identified to be the changing nature of labour itself. The first section of this paper outlined how labour flexibility and mobility are required to tackle the effects of globalisation on the labour markets. These have been established with varying success in the EU, but intra-EU mobility remains low. This is exacerbated by the finding that a growing number of people move outside of the EU to find work (Dhéret et al., 2013). This trend is worrying, as it clearly implies a mismatch between the labour demanded in the EU and the labour supplied. The conceptualisation of different labour divisions is a key requirement to understand the dynamics through which this mismatch is created.

As early as the 1990s, Robert B. Reich (1991) observed that the old service/production categorisation no longer holds. Instead, he identified three new job categories. First, routine production services, which have been declining in all industrialised countries, and are subject to international competition. Secondly, in-person services, such as personal trainers, which cannot be sold worldwide and have increased with globalisation. Lastly, people working in the expanding field of symbolic-analytic services, comprising of problem solving, problem-identifying, and strategic-brokering activities, who are competing on an international level, but with the advantage that their services cannot be standardised, leaving them the freedom to move following their preferences. Examples of this group are bankers, lawyers, accountants, and business people.

Without doubt, it is the latter group that benefits most from globalisation. Not only can members of this group expect high remuneration for their services, they have also gained considerably in bargaining power that the trade unions have lost. Moreover, they constitute the most mobile and flexible group, benefitting from the advantage of attracting the interest of multinational companies and organisations competing for their services. Furthermore, no other group is as well connected through global networks as the members of this group. These features have considerable consequences on income and power distributions, as well as on economic and social policies.

The implications are a reflection of the state of the global labour markets today: routine production workers compete with both technological innovations as well as with other routine production workers on an international scale, leading to a race to the bottom in terms of labour unit costs. In countries where this is politically, economically, and socially unfeasible, public policy encourages labour participation in the other two labour categories. With in-person service workers increasingly depending on the demand created by symbolic-analytic workers, given the declining spending power of routine production workers, governments increasingly provide incentives in the form of favourable policies. Furthermore, members of the latter group have little incentive to vote for redistributive policies. It is beyond the scope of this paper to discuss the tax related developments of the past three decades. However, it may certainly be argued that changes in the tax system have similarly contributed to the distortions of the labour markets. In conclusion, public, economic, and social policy have not been in tandem with the demands that the changing nature of labour created.

Bringing it Together

These three observations - the widening gap between wages and productivity, the drop in domestic demand, and the changing nature of labour – help to understand the dynamics at play. However, since each of them have only partial explanatory power, the introduction of a final element is necessary to fully understand the implications. The resolution, this paper argues, lies in the misinterpretation of the role of demand for private goods and service in the age of a globalised world. For decades, scholars and commentators have noted that the production of goods and services has achieved its original goal - the satisfaction of urgent needs such as food, clothing and shelter – a long time ago (Galbraith, 1999; Jackson, 2011). Moreover, well before the 1990s, John Kenneth Galbraith observed that,

> *"the process of by which wants are now synthesized is a potential source of economic insta bility. Production and therewith employment and social security are dependent on an in herently unstable process of consumer debt creation. This may one day falter. And decay in emulative compulsions or in the ability to synthesize demand could bring a fall in con sumption, an increase in unemployment and a difficult problem of readjustment" (Galbraith, 1999, p. 207).*

This observation is of paramount importance in understanding the systemic flaws in the labour market strategy of the EU's labour market. The economic security of individuals, which is based on the demands for private goods and services (required to increase perpetually), works only as long as this can be sustained and financed. Sustainability seems highly uncertain in the context of finite resources, negative environmental consequences and rising levels of inequality. The question of the financial feasibility of these demands has been answered unequivocally by the financial crisis and the run-up to it. Therefore, it may be argued that any strategy of the EU to reduce unemployment needs to re-examine the role of demand for private goods. Ultimately, strategies that fail to go beyond the creation of more demand for private goods and services are prone to be unsuccessful in the long run, as they fail to resolve the conflicts described in this paper. Possible directions are a move towards an increased production of public goods or the provision of income for non-market related activities. Concepts of a universal basic income, the negative income tax, or living wages are just a few examples of what future strategies may incorporate. However, this requires hard political choices. By acknowledging the aforementioned systemic flaws, the first step towards a real economic recovery may be accomplished.

Conclusion

In conclusion, the four freedoms have contributed significantly to the theoretical improvement of the functioning of the EU's labour market. In practice, though, the Great Recession has shown that the strategies employed by the European Commission have proven to be unsuccessful to handle the current crisis. This paper has examined the underlying dynamics responsible for the malfunctioning of the EU's labour market. Furthermore, it has been argued that only a critical reassessment of the fundamental role of the demand for private goods and services can provide the basis on which to build future strategies to tackle the distortions of the labour market.

References

Acemoglu, D., Aghion, P. & Violante, G. L., 2001. Deunionization, technical change and inequality. Carnegie-Rochester conference series on public policy. Elsevier, pp.229-264.

Cappelen, A., Castellacci, F., Fagerberg, J. & Verspagen, B., 2003. The impact of EU regional support on growth and convergence in the EU. JCMS: Journal of Common Market Studies, 41, pp.621-644.

Dhéret, C., Lazarowicz, A., Nicoli, F., Pascouau, Y. & Zuleeg, F., 2013. Making Progress Towards the Completion of the Single European Labour Market. EPC Issue Paper, 75. Available at: <http://www.europe-solidarity.eu/documents/ES_labour_market.pdf >[Accessed 29 December 2013].

Esteves, P. S. & Rua, A., 2013. Is There a Role for Domestic Demand Pressure on Export Performance? Working Paper Series [Online], 1594. Available at: <http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1594.pdf > [Accessed 9 January 2014].

European Commission. 2006. European Economic Forecasts - Autumn 2006. European Economy 5/2006 [Online]. Available:< http://ec.europa.eu/economy_finance/publications/publication7945_en.pdf> [Accessed 10 January 2014].

European Commission. 2013a. European Economic Forecasts - Winter 2013. european economy 1/2013 [Online]. Available at: <http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee1_en.pdf> [accessed 12 January 2014].

European Commission. 2013b. Labour Market Developments in Europe 2013. European Economy [Online], 6. Available at: <http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee6_en.pdf> [Accessed 08 January 2014].

Flassbeck, H. & Lapavitsas, C. 2013. The Systemic Crisis of the Euro - True Causes and Effective Therapies. Studien [Online]. Available at: <http://transform-network.net/uploads/tx_news/Flassbeck_Lapavitsas_Studie_EN.pdf> [Accessed 05 January 2014].

Galbraith, J. K.., 1999. The Affluent Societ. London: Penguin Books.

Harvey, D., 2005. A Brief History of Neoliberalism, Oxford, Oxford University Press.

International Labour Office., 2013. Global Wage Report 2012/2013 - Wages and Equitable Growth. Available at: http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_194843.pdf [Accessed 09 January 2014].

Jackson, T. 2011. Prosperity Without Growth: Economics for a Finite Planet, London, Routledge.

Kahneman, D., 2012. Thinking, Fast and Slow, London, Penguin Books.

Machin, S., 1997. The decline of labour market institutions and the rise in wage inequality in Britain. European Economic Review, 41, 647-657.

Mazier, J. & Petit, P., 2013. In search of sustainable paths for the eurozone in the troubled post-2008 world. Cambridge Journal of Economics, 37, 513-532.

Onaran, Ö. & Galanis, G., 2012. Is Aggregate Demand Wage-led or Profit-led? Conditions of Work and Employment Series [Online]. Available at: http://www.assoeconomiepolitique.org/political-economy-outlook-for-capitalism/wp-content/uploads/2012/06/onaran_ozlem_isaggregatedemandwageled.pdf [accessed 01 February 2014].

Reich, R. B., 1991. The Work of Nations: Preparing Ourselves for the 21st Century, New York: Vintage.

Reich, R. B., 2010. Aftershock: The next economy and America's future, New York: Random House LLC.

Streeck, W., 2011. The Crisis in Context: Democratic Capitalism and its Contradictions. Max-Planck-Institut für Gesellschaftsforschung Discussion Paper [Online], 11. Available at: <http://www.econstor.eu/bitstream/10419/51554/1/670480223.pdf [Accessed 10 November 2013]>.