15. March 2002

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COOPERATION PAYS

Cooperation and the co-ordination of economic policy benefit all parties. This paper outlines some of the economic potential within the EU.

First there is a summary of the positive economic effects that the Single Market brought with it when it was introduced.

Next, the result of a more progressive policy relative to the Lisbon Process is shown. Calculations show the effects in the EU of more education, a higher labour force participation rate, more flexible labour markets, greater competition and innovation in the EU. If the EU countries together put such a policy into practice the effect on employment would be far greater than if a single country took on the task alone.

Finally there is a demonstration of the way in which higher employment can be achieved in two ways. The first is to pursue a "working rich" strategy, where the levels of education and productivity are heightened. The second is to pursue a "working poor" strategy, where a higher rate of employment is arrived at through increased wage rage i.e. lower wages. The first strategy will bring about more prosperity and greater social coherence, while the second will lead to less prosperity and greater inequality.

1. The effects of the Single Market

The basic reason for the wish to establish the Single Market was to obtain greater benefit from the European collaboration.

During the 1960s customs duties and quantitative restrictions were rapidly abolished. This was possible in particular because a high rate of growth and

employment was experienced in Europe during this period. When progress turned into the economic crisis of the 1970s a tendency to utilise state subsidies and obstacles to trade unrelated to customs tariffs – including technical obstacles to trade – spread through the European countries – in order to protect the individual business communities. These circumstances led to a situation in which the European collaboration failed to function satisfactorily.

The reform package on the Single Market in 1985 was designed to give the European collaboration a shot in the arm. The aim of strengthening Europe's competitive ability relative to the USA and Japan was a contributory factor in the desire to establish the Single Market.

It is necessary to differentiate between two effects when evaluating the effects of the European collaboration on the reform package which was to realise the Single Market.

First, the effect that can be directly ascribed to the many directives regarding the Single Market.

Second, there are also the more dynamic effects which follow on the fact that trade and industry are experiencing an improvement in the economic climate and also that governments and the authorities responsible for monetary policy can take a more offensive line in economic policy as a direct consequence of the reform package.

While various evaluations of the direct effects have been carried out the indirect effects are more difficult to quantify. Cecchini, who lent his name to one of the central reports on the effects of the Single Market, drew attention to the fact that the dynamic effects could have a considerably greater effect than the more static effect that can be directly ascribed to the reform package.

In the Cecchini Report from 1988 it was predicted that the effect of the Single Market would heighten prosperity in the EU by four to five per cent, in addition to making an improvement in the rate of employment of between 1.5 to 2 million people.

An analysis carried out by Allen et al. from 1998 makes an attempt to measure the benefits in the individual countries on the basis of the benefit that consumers have obtained through the Single Market. This analysis shows a benefit of between 2 and 20 per cent of GDP, cf. table 1. Particularly smaller countries with extensive foreign trade have reaped great benefits as a consequence of the Single Market.

Table 1. Benefits of the Single Market

Extra consumption by per cent of GDP	Country
2-3	France, Germany, the UK, Italy
2-5	Denmark
3-4	The Netherlands, Spain
4-5	Belgium, Luxembourg
4-10	Ireland
5-16	Greece
10-20	Portugal

Source: Allen et al. "The competition effects of The Single Market in Europe", Economic Policy 1998

In a study from the Commission in 1996 the effects of The Single Market were evaluated for the period 1985 to 1991, and brought forward to 1994. The Commission has not carried out evaluations of the consequences of the effects of the Single Market since 1996.

In the study the Commission arrives at a gain in prosperity of 1.5 per cent and an increase in the rate of employment of up to 620,000 jobs from 1985 to 1994. According to the study the Single Market has also led to more investment, more trade, greater productivity, higher real earnings, and lower prices, cf. table 2.

Table 2. Effects of the Single Market, 1985-91 – projected in 1994

	Per cent
GDP	1.5
Employment	0.5
Investments	4.5
Intra EU trade	4.7
Productivity	1.0
Real earnings	1.9
Consumer prices	-0.7

Source: NTUA, CES & Middlesex University, Aggregate Result of the Single Market Programme, December 1996

The European collaboration on the Single Market has therefore created growth and employment in addition to increasing real earnings and prosperity. The higher rate of investment and higher productivity have contributed to this "working rich" development.

2. Job creation via the Lisbon Process

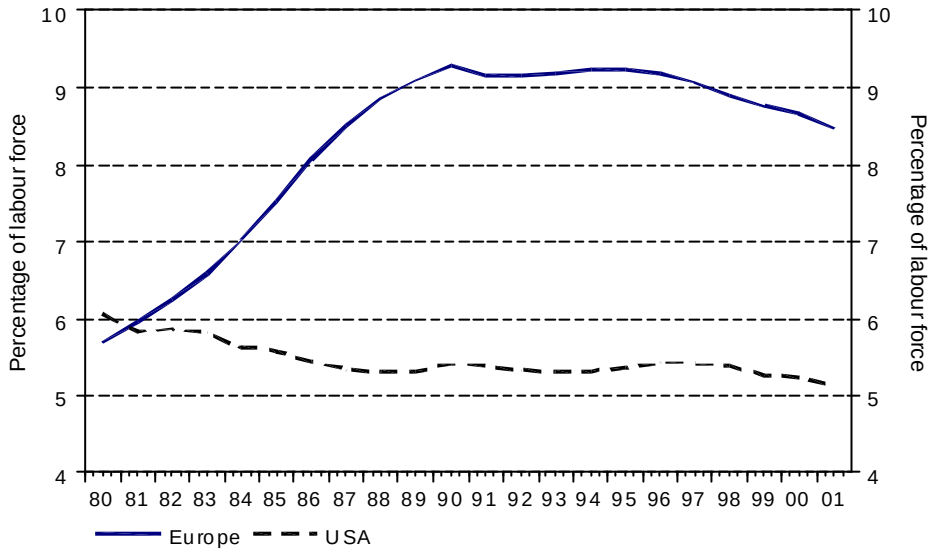
The natural continuation of the Single Market is the Lisbon Process. The objective of the Lisbon Process is for the EU to become the most competitive and dynamic knowledge-based economy in the world, an economy that can create sustainable economic growth with more and better jobs and greater solidarity. Investments in education and a strengthening of business and labour market policies will make it possible for Europe to achieve this objective.

One of the major problems for European job creation is that barriers and inflexible markets limit the opportunities for longer-term economic progress – and thereby the opportunities for a lasting increase in employment.

Problems with inflexible markets can be illustrated through the development of structural unemployment. Structural unemployment is often interpreted solely as an indicator of the development of the way in which the labour market functions. But this is not correct. Conditions on the labour market and the market for goods determine developments in structural unemployment. Poorly functioning competition, barriers preventing access to capital, too few innovative measures, etc., will also be reflected in a high rate of structural unemployment.

Chart 1 shows the development in structural unemployment in Europe over the past 20 years compared with the development in the USA. The comparison between structural unemployment in Europe and the USA is not an expression of the idea that the American model should be chosen, which is something we will return to later in this paper. Chart 1 solely illustrates that the level of structural unemployment in Europe is high and has been relatively constant throughout the 1990s.

Chart 1. Structural unemployment



Note.: The chart shows the OECD's NAIRU definition for the European countries and the USA.
Source: Economic Outlook, no. 70.

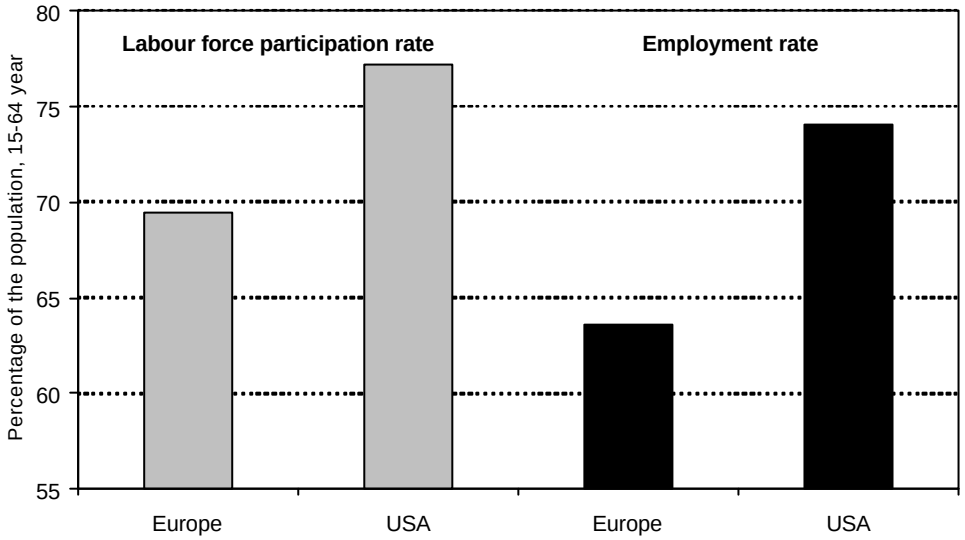
It is necessary that the European labour markets and product markets come to function better. This will reduce structural unemployment and thereby create opportunities for an increase in employment. If structural unemployment in Europe is not reduced an increase in the rate of employment will be of shorter duration, as economic recovery will be hampered by bottlenecks and growing wage and price rises.

A decisive factor that is at least equally important with regard to the opportunity for European job creation is the development in the labour force participation rate. An increase in the labour force participation rate, particularly for women and older people, is necessary in order to increase

the labour force. The size of the labour force – together with the level of structural unemployment – will in the longer term determine the development in the rate of employment.

Chart 2 compares the labour force participation rate, which measures the labour force relative to the population of employable age, and the employment rate, which measures the rate of employment relative to the population of employable age.

Chart 2. Labour force participation rate and employment rate



Note: The figures are for 2000.
Source: OECD, Employment Outlook, June 2001.

The labour force participation rate in European countries is relatively low. This, combined with the fact that unemployment is relatively high, means that the employment rate is low.

The following is a calculation of the effects of a specific employment package, which takes its point of departure in the Lisbon Process. The calculations have been carried out both for Europe as a whole and (as an example) for Spain alone. A comparison of the effects of employment and prosperity in the two cases illustrates the positive, dynamic effects that would be created if all European countries united to implement the Lisbon Process – rather than this being carried out solely by individual countries.

2.1 A unified European effort towards 2010

A goal-oriented effort in Europe could be highly significant for growth and employment. As an illustration of this the following section contains a calculation of the effects of an employment package. The package includes many of the components that were launched under the Lisbon Process.

The employment package, which the following calculations are based on, contains investments in education, an increased labour force participation rate for women and older people, a strengthening of an active labour market policy and a strengthening of business policy which focuses on increased competition and innovation, liberalisation and easier access to capital.

Education

According to the OECD the EU countries spend an average of approximately 4.8% of GDP on education. Sweden leads with an overall spending in this area of 6.2% of GDP. Table 3 shows the distribution of spending on primary, secondary and tertiary education respectively.

Table 3. Total spending on education in percentage of GDP, 1998

	Primary and secondary education	Tertiary education	Total
Sweden	4.5	1.7	6.2
The EU	3.7	1.1	4.8
Difference	0.8	0.6	1.4

Note.: The table shows both public and private spending on institutes of education.
Source: OECD "Education at a glance – OECD indicators", 2001. Table B2.1c and the weighting of the OECD's GDP.

On average the EU lies 1.4% of GDP lower than Sweden. Sweden is the EU country that devotes most funds to education – and that also demonstrates best practice on this point.

In the short term a higher rate of education in the EU will lower the supply of labour, as some of the extra students would otherwise have been available on the labour market. An extra investment in education corresponding to half of the difference up to the Swedish level would increase the number of

students by between 800 – 900,000, of which a certain number will come from the labour force.

However, in the longer term education will increase the labour force participation rate, as people with a better education can obtain higher salaries, better jobs and avoid the wear and tear of manual labour to a greater degree. Table 4 shows the labour force participation rate for people with different educational backgrounds. It is clear that women in particular with only a lower level of education have a very low labour force participation rate.

Table 4. Labour force participation rate distributed by education, 1999

	Less than upper secondary education	Upper secondary education	Tertiary education
Both sexes	61.0	79.7	88.2
Men	77.8	86.9	91.4
Women	46.3	72.0	84.3

Note.: The table shows the labour force participation rate for 25 - 64 year-olds in the EU.
Source: OECD "Employment outlook", June 2001.

A higher level of education therefore increases the labour force participation rate and, up to 2010, this will counteract the fall in the labour force as a consequence of the fact that participation in education will increase.

Box. The employment package in the education area

In our calculations we assume that spending on education in the EU countries will grow, so that the difference between the EU on average and Sweden will only be half as great in 2010. This means an increase in spending on education of 0.7% of GDP in the EU on average.

We assume that half the extra students would otherwise have been on the labour market. In the short term this corresponds to a fall in the labour force of 0.25 per cent. However, in the longer term this will be counteracted by the higher labour force participation rate for people with higher levels of education.

Higher labour force participation rate for women

According to the Lisbon strategy the rate of employment for women in the EU must on average reach 60 percent in 2010. In order for this to succeed the labour force participation rate for women must be increased.

This can be brought about by heightening the level of education for women and by making it easier to create cohesion between family life and working life. An increase in the labour force participation rate for women requires such measures as creating better facilities for child and elderly care.

In many European countries the employment rate for women with small children is much lower than for women on average. By creating better facilities for child care it would be possible to increase the employment rate with regard to these women.

Box. Employment package for women

In order to achieve the objective of an employment rate of 60 for women in 2010 the labour force participation rate for women in the EU must be increased. Our calculations incorporate an overall increase in the labour force participation rate for women of approximately 3.2 percentage points by comparison with today.

If this is to succeed, better public service in the fields of child minding and care of the elderly are required. Employment within these areas is therefore being increased. In our calculations this means an overall increase of approximately 1.5 million up to 2010 in the number of people employed in the fields of child minding and care of the elderly.

Increased labour market participation rate for older people

A new objective of increasing the labour market participation rate for older people (55 - 64 year-olds) to 50 percent in 2010 was established at the Stockholm summit in March 2001. Our calculations are based on the assumption that this objective will be fulfilled.

The objective can be pursued with the help of reforms in the pension systems, which will cause savings for the public sector, and with the help of initiatives that will increase expenses. The final effect on public finances is therefore undetermined.

A more well functioning labour market

More measures on behalf of education and higher priority for an active labour market policy would limit mismatch problems on the European labour market.

A more well-educated labour force would minimise the number of cases where there is a lack of people with technical or longer-term courses of higher education – at the same time as there are unemployed people who lack courses of education which provide labour market qualifications.

A more active labour market policy would maintain and extend the qualifications of the unemployed so that they would be able to take on new jobs as these arise.

From an overall point of view a more well functioning labour market would make it possible to increase the employment rate to a greater degree without this progress being hampered by bottlenecks.

Box. A more well functioning labour market

In the model predictions labour markets which function better would mean that unemployment in Europe could be lowered more without this resulting in major wage increases as a consequence of bottlenecks, etc.

In practice the more flexible labour market has been incorporated in the calculations by gradually moderating the effect of an increase in employment on wage increases. Seen in isolation the pace of wage increases will be 0.2 percentage points lower in 2010 than it otherwise would have been.

More well functioning product markets

Heightened competition and innovation, liberalisation in such fields as gas, electricity, postal services and transport, and easier access to capital for trade and industry are important areas where measures could be carried out in the Lisbon Process.

Better competition would put a damper on price development for the benefit of European consumers. Moreover, the removal of a number of barriers in connection with the access of trade and industry to capital would ensure an increase in and more appropriate investments. This would support the development of a dynamic business community which focuses on innovation.

Box. A more well functioning product market

It is assumed in the calculations that improved competition would reduce the development in profits, which would correspond to the level of prices in 2010 being just under 1 percentage point lower than it otherwise would have been.

An increased effort with regard to innovation and easier access to capital are assumed to bring about a gradual lift in the private investment ratio. Seen in isolation, in 2010 this would mean an increase of a ½ per cent of GDP.

The effects of the package

Table 5 shows the overall effects of a co-ordinated implementation of the employment package on European growth and employment.

Table 5. The effect of the employment package in the EU

	2005	2010
	Millions	
Employment	4.0	11.3
	Percentage of population, 15-64 years	
Rate of employment	1.6	4.3
	Per cent	
GDP	2.4	7.3
Productivity	0.3	0.9
	Percentage of GDP	
Public balance	-0.6	-0.3

Note: * This is productivity in the private sector.
Note: The effects have been measured relative to a basic course.
Source: ECLM's calculations based on the HEIMDAL model.

The table shows that a purposeful effort designed to increase the rate of employment with the help of some of the means presented in the Lisbon Process would have a great effect. As early as 2005 employment will have increased by 4 million and by 2010 the employment package will have created more than 11 million extra jobs. This corresponds to an increase in the rate of employment of more than four percentage points.

GDP in 2010 will be more that seven per cent higher than it otherwise would have been and productivity will be almost one percentage point higher. Although the policy includes state investments in education and more people employed in the fields of child minding and care of the elderly the burden on public finances in 2010 will only be 0.3 per cent of GDP. This is due, among other things, to the fact that an increase in the labour force participation rate and the rate of employment will make a positive contribution to public budgets.

2.2 An effort in individual countries

The greatest benefits can be achieved through a co-ordinated implementation of the employment package throughout Europe. If only a minority of member states implement the package the effect – in the individual countries – will be correspondingly lower.

The reason for this is that Europe is an economic entity. Investments in employment in one European country will therefore also have a positive influence on employment in other European countries. And the greatest common benefit will be achieved if all countries work together.

As an example, the effects of the employment package on Spanish growth and employment are shown in a scenario where there is a co-ordinated effort – corresponding to table 5 – and in a scenario where Spain alone implements the employment package. The difference between a co-ordinated and an uncoordinated effort is shown in table 6.

Table 6. The effect of the employment package on Spain, 2010

	Uncoordinated	Co-ordinated	Difference
		1000 people	
Employment	900	1050	+150
		Percentage of population, 15 - 64 years	
Rate of employment	3.5	4.1	+0.6
		Per cent	
GDP	4.8	6.0	+1.2
Productivity*	0.4	0.4	0
		In percentage of GDP	
Public balance	-0.8	-0.2	+0.6

Note: * This is productivity in the private sector.
Note: The effects have been measured relative to a basic course.
Source: ECLM's calculations based on the HEIMDAL model.

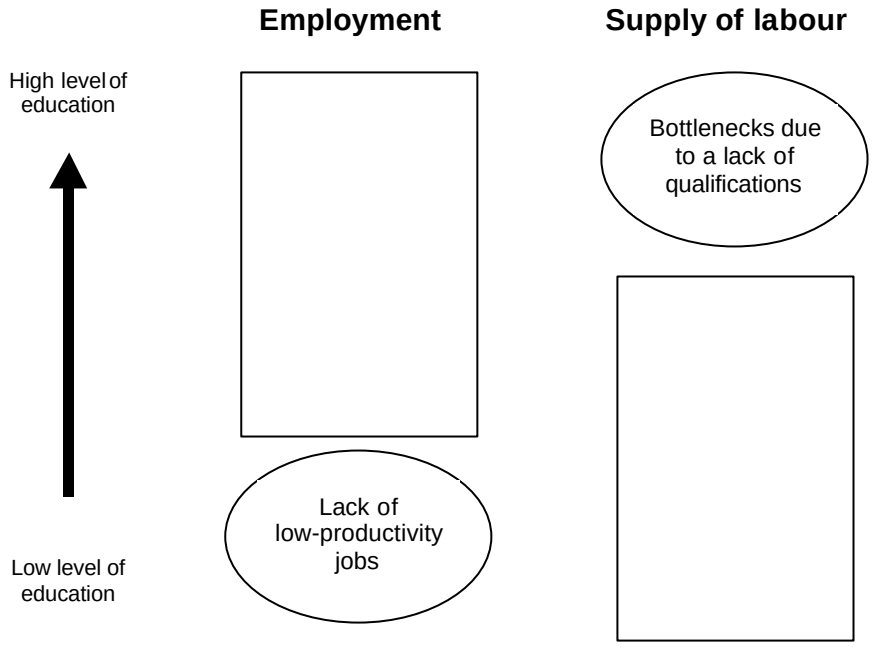
As can be seen from table 6 a co-ordinated effort increases the effects on growth and the rate of employment. Spanish prosperity will be increased by 1.2 per cent and 150,000 extra jobs will be created if the effort is co-ordinated throughout Europe. As a result of this, what is on the face of things the negative influence on the public balance, will be less in connection with a co-ordinated effort. The effect on productivity is of the same order in both cases.

3. Working rich or poor

Seen from an overall point of view there are two paths along which it is possible to achieve a higher rate of employment. There is the low wage strategy, with the maintenance and creation of low-productivity jobs; and there is the investment strategy, where education and an upgrading of qualifications ensures the maintenance and creation of high-productivity jobs.

The background for the two paths is illustrated in chart 3. Companies are seeking a slightly higher qualification interval than the labour force possesses. This is illustrated by the two squares in chart 3.

Chart 3. Illustration of imbalance on the labour market

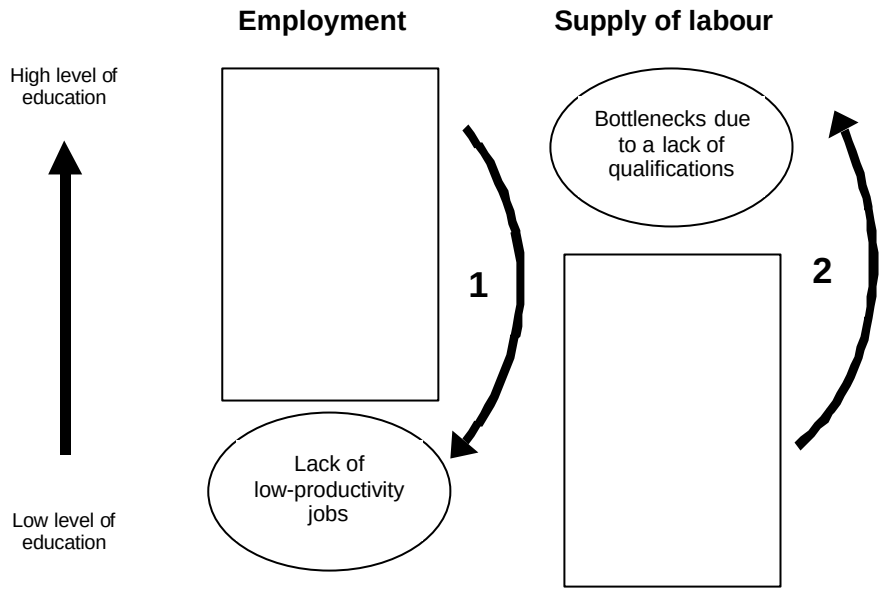


When there is a high level of unemployment the mismatch between the qualification interval for the supply of and demand for manpower is not so visible. In this case the demand for manpower with the necessary qualifications is not higher than the supply. However, the problem is not quite invisible, as there will always be a tendency for unemployment to be higher among those with a lower level of education than among those with a higher level of education – that is an unequal distribution of unemployment.

The mismatch becomes more visible when there is an economic upswing. In this case bottlenecks will arise – a lack of people with the right qualifications – at the same time as there will be unemployed people without the right qualifications.

The two potential solutions to the mismatch on the labour market are illustrated in chart 4 by arrows 1 and 2.

Chart 4. Two paths to a reduced mismatch on the labour market



The low wage strategy – working poor – is illustrated by arrow 1. This strategy could help to create the opportunity for low-productivity jobs to arise – illustrated by the fact that demand adapts to the qualifications that can be supplied.

The education strategy – working rich – is illustrated by arrow 2. An increase in education and qualifications will increase the level of qualifications in the labour force, whereby the supply will adapt to the qualifications in demand.

The effects of creating two million European jobs with the help of the low wage strategy and the education strategy respectively up to 2010 are presented below. The scale itself – the two million extra jobs – is not quite so important. The difference in the effects between the two strategies is more so.

The low wage strategy

This path creates jobs by reducing minimum wages in order to create the possibility of low-productivity jobs arising and being maintained. The strategy will come to expression in a lower development of productivity.

The education strategy

This path creates jobs by investing in education and increasing the upgrading of skills. This will reduce bottlenecks on the labour market – increase the effective supply of labour – and make it possible for more high-productivity jobs to arise and be maintained. The strategy will come to expression in a higher development of productivity.

The effects

Table 7 shows the effects of the two strategies. Although the effects on employment are the same in the two experiments there are positive effects on prosperity from the working rich strategy, whereas these are negative for the working poor strategy. This is due to the fact that the first strategy concentrates on creating high-productivity jobs while the second concentrates on creating low-productivity jobs.

Table 7. The effects of "working rich" and "working poor", 2010

	Working rich	Working poor	Difference
		Millions	
Employment	2.0	2.0	0.0
		Percentage of population, 15-64 years	
Rate of employment	0.8	0.8	0.0
		Per cent	
GDP	1.3	-0.3	1.6
Productivity*	0.5	-1.7	2.2
		Percentage of GDP	
Public balance	-0.4	0.1	-0.5

Note: * This is productivity in the private sector.
Note: The effects have been measured relative to a basic course. The table shows the overall effect on the EU.
Source: ECLM's calculations based on the HEIMDAL model.

The education strategy has its costs in the form of investments in education and upgrading qualifications. This is therefore a burden on public budgets. On the other hand the low wage strategy will not be a burden on public budgets. The low wage strategy is paid for by the people who must accept lower pay in order to gain employment. The choice of strategy therefore depends very much on who it is felt should "pay" for the creation of jobs. Should this be a matter of joint investment, or must the people who are unemployed pay?