

Economic policies for full employment in Europe

08/05/2008

**"FINANCIAL CRISIS
THREATENS EMPLOYMENT
AND GROWTH - POLICY
RESPONSE NEEDED"**

**2008 ELNEP ECONOMIC
FORECAST AND POLICY
RECOMMENDATIONS**

**EURO AREA GROWTH TO DECLINE TO
1.6% IN 2008 AND 1.5% IN 2009**

**NO FURTHER FALL IN
UNEMPLOYMENT OR IMPROVEMENT
IN PUBLIC FINANCES**

**WAGE GROWTH TO REMAIN
MODERATE DESPITE PRICE RISES**

**INFLATION TO DECLINE FROM 2.9%
IN 2008 TO 1.9% IN 2009**

**ECB SHOULD CUT BASE RATES BY 50
BASIS POINTS IMMEDIATELY TO
STABILISE EXPECTATIONS, BOOST
GROWTH AND JOB CREATION**

**FISCAL POLICYMAKERS SHOULD
ALLOW THE AUTOMATIC
STABILISERS TO OPERATE FULLY**

**FINANCIAL MARKET REGULATION
MUST PROMOTE TRANSPARENCY AND
PREVENT UNWARRANTED RISK
TAKING, WHILE AVOIDING
SOCIALISING LOSSES WHEREVER
POSSIBLE**

**QUALITY JOB CREATION AND RISING
SHARES OF LOW-PAID WORKERS
REMAIN MAJOR CHALLENGES**

The European Labour Network for Economic Policy (ELNEP) releases today (8th May 2008) its spring forecast. The forecast covers main economic developments and presents forecasts and scenarios for the euro area for 2008 and 2009. A companion chapter analyses developments on the euro area labour market since 1999.

The ELNEP economic forecast

The ELNEP forecasts euro area GDP growth to fall by a full percentage point to 1.6% in the current year. Private consumption will remain weak, hit by higher prices. All other main demand components will weaken compared with 2007. Growth will not pick up significantly until the end of 2009 at the earliest. The welcome fall in unemployment will come to a halt at 7.1%.

Inflation, currently high due to energy and food price hikes is expected to decline during the forecast period, averaging 2.9% this year and returning to the ECB target of 1.9% next year. Collectively agreed wages are expected to grow by only 3.0% in the current year. Unit labour cost growth will be 2.0% this year and 1.9% next year. The wage anchor is still holding despite higher prices.

The combination of external shocks and the financial crisis will bring to an end the brief period of strong growth that has brought down unemployment and helped to narrow fiscal deficits. Moreover, the downside risks to growth have intensified. ELNEP estimates that a stronger slowdown in the US and continued financial turbulence that keep inter-bank interest rates at elevated levels would reduce GDP in 2009 by a further 0.5% and cost 400,000 jobs compared with the forecast.

What should be the response of European policy makers?

Monetary policy:

ELNEP calls on the European Central Bank (ECB) to swiftly cut its base rates by half of one percent now and by another 50 basis points until the end of 2008 to stabilise consumer and business expectations and prevent an unnecessary and potentially drawn-out downturn in growth. The cuts later in the year are already assumed in the forecast: the immediate cut could boost GDP by 0.3% in 2009 and add 200,000 jobs compared with the forecast. It would also ensure that unemployment kept falling. The cost in terms of higher inflation would be negligible.

Fiscal policy:

Provided monetary policy acts to underpin economic activity, fiscal policymakers in most euro area countries need not take explicit counteraction, unless the economic situation takes an unexpected turn for the worse. However they should allow the built-in stabilisers to work in full, accepting the slight rise in deficits that come automatically through higher spending and reduced tax revenues. Some hard-hit countries with fiscal ammunition (Spain, Ireland) should use their room for fiscal stimulation. Fiscal policymakers should be seeking to raise public investment in areas that promote longer-term growth.

Wages policy and collective bargaining:

The ELNEP encourages wage-setters to stick to the forecast course. The average rate of wage increases is set to accelerate slightly, helping to sustain demand and consumption. However it will remain compatible with medium-run price stability in the face of temporarily higher inflation. An acceleration in Germany is particularly needed to help balance competitive tensions within the euro area.

Financial market regulation:

Urgent steps are needed to ensure that financial markets actors behave in ways that promote, rather than endanger, the growth of the real economy. Past liberalisations and the successful efforts of financial market institutions to evade existing regulation have been shown to be highly dangerous. The most important short-term aim is to restore the functioning of financial markets, but the means chosen to achieve this aim should avoid socialising the losses of institutions that, in the past, successfully privatised their gains. In the medium term, effective re-regulation of the financial sector is needed to ensure greater transparency, prevent undue risk-taking and risk distribution and ensure adequate safety buffers (such as capital adequacy) in ways that reduce rather than promote economic instability. Regulation should provide for European and international coordination and, where appropriate, the centralisation of supervisory authority to prevent national jurisdictions being played off against each other.

More and better jobs? The jury is out.

This year, the ELNEP network has analysed in detail the labour market of the euro area since the start of monetary union in 1999.

Some of the key findings:

- Job growth has been strong. Creating better jobs has however not been so successful. Non-standard contracts are increasing, collective interest representation is declining. Unemployment has declined significantly but still remains higher than in the US and non-EMU western European countries.
- Wage setting remains moderate and consistent with price stability in EMU as a whole, but with higher inflation, national income continues to be shifted from wage to profit income, depressing the wage share. At the same time, divergences between countries unit labour cost developments have led to competitive tensions within the currency union
- The euro area has a productivity problem. The weakening of collective bargaining, which has reduced the pressure on firms to rationalise production, is an important cause.
- In terms of job quality, part-time work and fixed-term contracts have increased inexorably while wage inequality has grown significantly in several euro area countries.
- In a quantitative analysis of job quality in the EU15 using fifteen separate indicators the Scandinavian countries come out top, along with the Netherlands and the UK. The southern European countries perform worse. Worryingly the better-performing countries have improved their scores since 2000, whereas the laggards appear to have fallen further back.

The ELNEP economic forecast and policy recommendations for 2008-9 and the euro area labour market analysis will be available on the ELNEP website www.elnep.org from 8th May.

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***Also available:
ELNEP factsheet and list of member organisations in [English](#),
[French](#) and [German](#), 2007 April [forecast](#) and October [update](#)***

ELNEP

The **ELNEP** was founded in autumn 2006 to provide a counterweight to mainstream economic policy advice in Europe. The participating institutes identified a worrying lack of diversity in the European economic policy debate, which is biased heavily towards the supply side, exhibits a knee-jerk preference for 'market' solutions over social institutions, and draws conclusions from the micro for the macro level and from national for European policies even where this is not appropriate. The analytical and forecasting activities of the **ELNEP** put greater emphasis on macroeconomic policies and consider both demand and supply side measures to be crucial in supporting growth and employment. The network pays particular attention to issues of the labour market, employment, wages and income distribution, and wherever appropriate takes a European, rather than national, perspective: policies that may work in a single country may be counterproductive at European level. The members of the network are financially and intellectually independent. At the same time they have institutional links to national labour movements, providing additional insights in the area of pay developments. The regional diversity of the network ensures in-depth expertise at country level.

