

On the difficulty of carrying out structural reforms in a period of high unemployment

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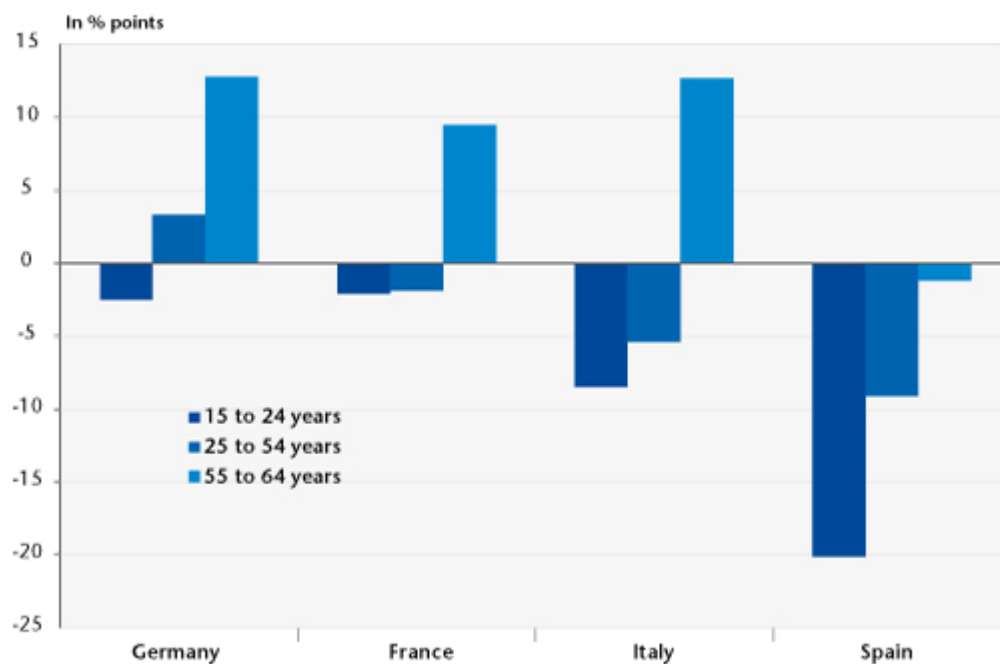
Structural reforms aimed at developing a more flexible labour market are often attributed all the virtues of fighting against mass unemployment and limiting the segmentation of the labour market between “insiders” on stable contracts and “outsiders” who are unemployed or on precarious contracts. When the economy is growing, these measures can facilitate job creation for the benefit of the outsiders, but the results are likely to be more uncertain in a context of mass unemployment and sluggish growth. Structural reforms can indeed reduce the labour market duality arising from regulatory measures but they cannot combat the duality of the labour market inherent in human capital, which is exacerbated during periods of mass unemployment: given the same qualifications it is experience that makes the difference, and given equal experience it is qualifications that make the difference. High unemployment therefore strengthens the phenomenon of “queuing” to access more stable jobs. Structural reforms aimed at streamlining the labour market will thus primarily affect employees who have less qualifications and experience without however enabling outsiders to gain access to more stable employment. This means that inequality between workers is likely to rise, with no positive impact on employment due to the sluggishness of the economy. Only macroeconomic management that takes on board the goal of returning to full employment could lead to successful structural reform.

As we show in a special study, [“La dévaluation par les salaires dans la zone euro: un ajustement perdant-perdant”](#)

[\[Devaluation through wages in the euro zone: a lose-lose adjustment\] \(Revue de l'OFCE, no. 136, November 2014\)](#), labour market segmentation has increased during the crisis despite the implementation of structural reforms in the euro zone countries. Since 2008, the employment rate [\[1\]](#) of seniors and of the better qualified has fared better than for other population groups in the four largest countries in the euro zone (Figures 1 and 2).

The sharp decline in the youth employment rate since 2008 is general – including in Germany, where the labour market has remained dynamic – and contrasts with the increase in the employment rate of older workers (or the small decline in Spain). The difference between these two categories is between 12 percentage points in France and 21 points in Italy (15 points in Germany and 19 in Spain). The adjustment in the employment rate of the 25-54 age group lies in an intermediate position. The resistance of the employment rate of older workers to the crisis is probably due to a combination of two factors: the introduction of pension system reforms in recent years (lengthening contribution periods and / or raising the legal retirement age) and the relatively higher cost of dismissing senior citizens, who more often occupy higher positions in the job hierarchy. In a crisis, it is likely that this has led to a substitution effect with the employment of older workers coming at the expense of the young.

Figure 1 : Changes in employment rate by age group between 2008 (Q1) and 2014 (Q2)

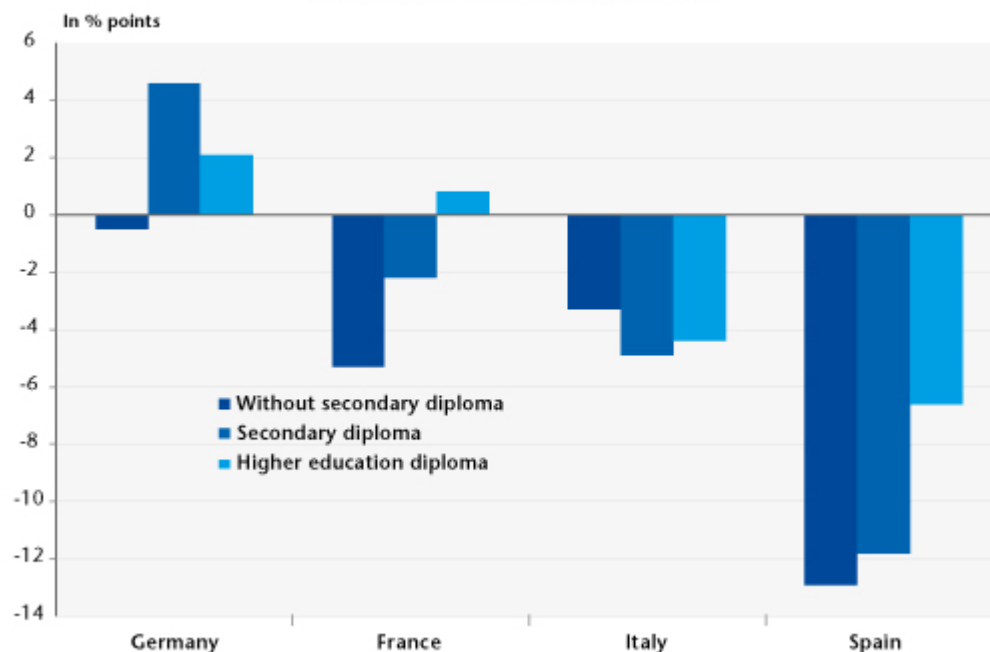


Sources : Eurostat, OFCE calculations.

The adjustments in employment rates were also more striking for people without a high school diploma, with the exception of Italy, where the diploma does not seem to provide protection from unemployment or inactivity. In France, the adjustment in the employment rate clearly decreased with the type of degree. In Germany, the employment rate for those with less education has declined during the crisis while it has increased for the other categories. In Spain, the employment rate of university graduates has withstood the crisis better than the rate of other population groups. In addition to these developments in employment rates by educational category, wage income in Italy, Spain and France has fallen for the initial income deciles. This adjustment in the wage incomes of the lower deciles is probably due to a reduction in total working hours over the year (part-time work, shorter temporary contracts or longer periods of unemployment between contracts, reducing average compensation over the year). Thus, in the countries hit hardest by the crisis, the most vulnerable populations, with the least human capital, have found themselves more exposed to a deteriorating labour market, whether this has been felt through falling employment rates or

a reduction in annual wage earnings.

Figure 2 : Changes in employment rate by level of diploma between 2008 (Q1) and 2014 (Q2)



Sources : Eurostat, OFCE calculations.

In the context of a deteriorating labour market, by accepting a slight downgrade the most qualified unemployed workers would be the first to find jobs, chasing out those who might otherwise have gotten it, who would themselves do the same thing at a lower level. This could explain why, at the end of the queue, it is the least skilled who are, regardless of labour legislation, the victims of unemployment and precarious employment.

The existence of a “spontaneous” segmentation in the labour market and the phenomenon of “queuing” may thus limit the success of a strategy of structural reforms and wage devaluation. In such a case, a more flexible labour market combined with a reduction in social welfare could increase inequalities between groups in the workforce without increasing the creation of full-time equivalent jobs.

[\[1\]](#) This is the ratio of the employed to the working-age population.

A fiscal policy to promote structural reform – lessons from the German case

By [Eric Heyer](#)

“France should copy Germany’s reforms to thrive”, Gerhard Schröder entitled [an opinion piece in the Financial Times on 5 June 2013](#). As for the European Commission (EC), its latest annual recommendations to the Member states, released on 29 May, seem to take a step back from its strategy of a rapid and synchronized return to balancing the public finances, which has been in place since 2010. The EU executive’s priority now seems to be implementation of structural reforms of the labour and services markets in the euro zone countries. These countries will of course continue to consolidate their public finances, but the EC has given them an extra year or two to do this. While, for example, France will further consolidate its accounts over the coming two years (the fiscal effort demanded of the French government by the EC comes to 0.8 percent of GDP, or 16 billion euros per year), it has been given another two years to bring its deficit below 3% of GDP (2015 instead

Tableau. New fiscal targets after postponement

		2013	2014	2015	2016
France	Government deficit (% of GDP)	3,9	3,6	2,8	
	Fiscal impulse (GDP points)	-1,3	-0,8	-0,8	
Spain	Government deficit (% of GDP)	6,5	5,8	4,2	2,8
	Fiscal impulse (GDP points)	-1,1	-0,8	-0,8	-1,2
Netherlands	Government deficit (% of GDP)	3,6	2,8		
	Fiscal impulse (GDP points)	-0,6	-0,7		

Source : European Commission.

of 2013).

This change in course – or at least in tone – by the EC, which had emphasized the enactment of extreme austerity reforms, should be welcomed. However, it is important to consider whether the new environment, in particular the fiscal situation, will be favourable enough to ensure that the structural reforms are effective. An examination of the economic context in which Germany introduced its reforms in the early 2000s, which became a benchmark for the countries of southern Europe, provides some important lessons. While the purpose here is not to go into these reforms in depth, it is nevertheless useful to remember that they were enacted while the German economy had a substantial trade deficit (-1.8 percent of GDP in 2000 against a surplus of 1.4 percent for France at that same time) and was considered a “low achiever” in Europe. These reforms led to a significant reduction in the share of wages in value added, boosting the margins of German business, and helped to quickly restore the competitiveness of the German economy: by 2005, Germany was once again generating a large trade surplus while France ran a deficit for the first time since 1991. The non-cooperative character of the the euro zone ([OFCE, 2006](#)) and the steep increases in Germany in poverty – ([Heyer, 2012](#)) and Figure 1 – and in wealth inequality ([de Grauwe et Yi, 2013](#)) were the hidden fruit of this strategy. Europe’s “low achievers” today are the southern European countries, and the pressure to take steps to boost competitiveness has shifted from Germany to France, Italy and Spain. Despite this parallel, the question remains: is the economic environment similar today? Figures 1 and 2 summarize the economic situation in Germany at the time

the structural reforms were implemented. Two main points stand out:

1. These reforms were carried out **in a context of strong global growth**: the world experienced average growth of over 4.7% per year in 2003-2006 (Figure 1). By comparison, the figure for growth is likely to be less than 3% over the next two years;
2. In addition, the fiscal situation of the German economy in the early 2000s was not good: in 2001, the general government deficit for Germany exceeded 3%, and came close to 4% in 2002, the year before the enactment of the first Hartz reform. Government debt then exceeded the threshold of 60% of GDP allowed by the Maastricht Treaty for the first time. Despite this poor fiscal performance – with public debt approaching 70% in 2005 – it is interesting to note that the German government continued to maintain a highly expansionary fiscal policy for as long as the reforms had not been completed: in the period 2003-2006, the fiscal impulse was positive at on average 0.7 GDP point each year (Figure 2). Thus, during this period **the German government supported its structural reforms with a highly accommodative fiscal policy**.

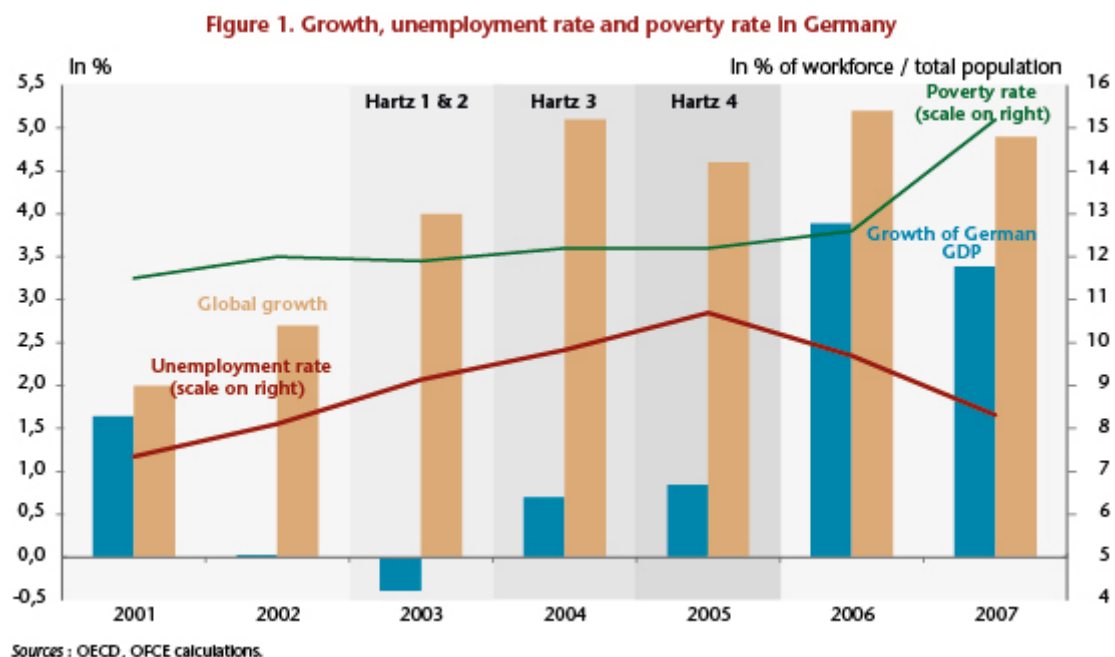
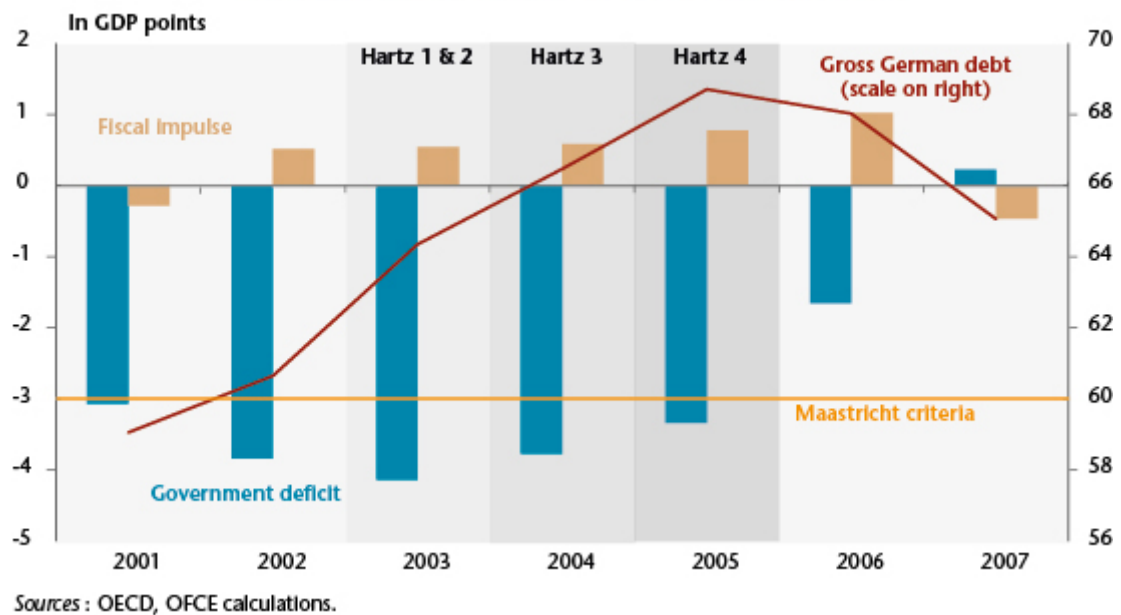


Figure 2. State of deficit and fiscal policy in Germany



Thus not only was the structural reform of the labour market conducted under Schröder implemented in a very favourable economic environment (strong global growth and a strategy that differed from the other European countries), but it was also accompanied by a particularly accommodative fiscal policy, given in particular the poor state of Germany's public finances. This situation differs greatly from contemporary conditions:

1. Global growth is likely to be under 3% over the coming two years;
2. The EC is asking a large number of European countries to implement the same structural reforms simultaneously, which in a highly integrated euro zone limits their effectiveness; and
3. Despite the extra time being granted for deficit reduction, fiscal policy will remain very tight: as is indicated in Table 1, the fiscal impulses for France and Spain will still be very negative (-0.8 GDP point per year) as the structural reforms in these countries are being implemented.

So while the pressure to boost the competitiveness of the countries of southern Europe is similar to that facing Germany

in the early 2000s, the external environment is less favourable and there is greater pressure to reduce the public debt. On this last point, the German example teaches us that it is difficult to juggle structural reforms to boost business competitiveness with efforts to reduce the public debt.