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**COMMISSION WORKING DOCUMENT**

**EUROPEAN COMMISSION BACKGROUND PAPER TO THE EPSCO COUNCIL**

**THE EMPLOYMENT CRISIS  
TRENDS, POLICY RESPONSES AND KEY ACTIONS**

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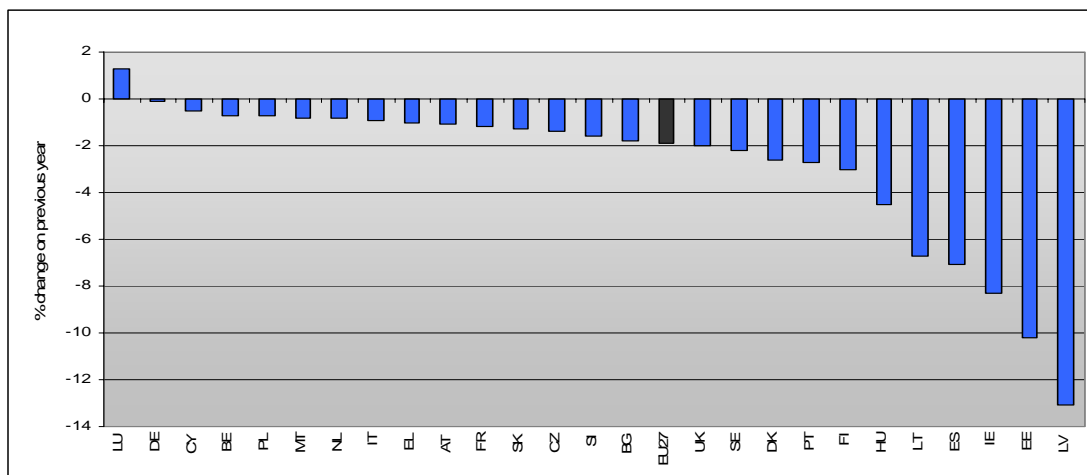
**THE EMPLOYMENT CRISIS  
TRENDS, POLICY RESPONSES AND KEY ACTIONS**

## 1. TRENDS IN EU LABOUR MARKETS

### *Weak economic performance led to employment contraction and unemployment...*

By mid-2009 employment in the EU had contracted by 4.3 million (1.9%) compared with a year earlier, across almost all sectors but with a particularly pronounced deterioration in construction and industry. Labour market performance worsened across all Member States, but most notably in the Baltic States, Ireland and Spain, which have all been affected by severe housing market downturns leading to employment contraction in the construction sector. In contrast, in certain Member States such as Belgium and Germany employment levels have remained relatively resistant to the effects of the crisis, in part due to extensive recourse to short-time working arrangements and other measures (Chart 1).

*Chart 1: Percentage change in employment across EU Member States 2008q2–2009q2*

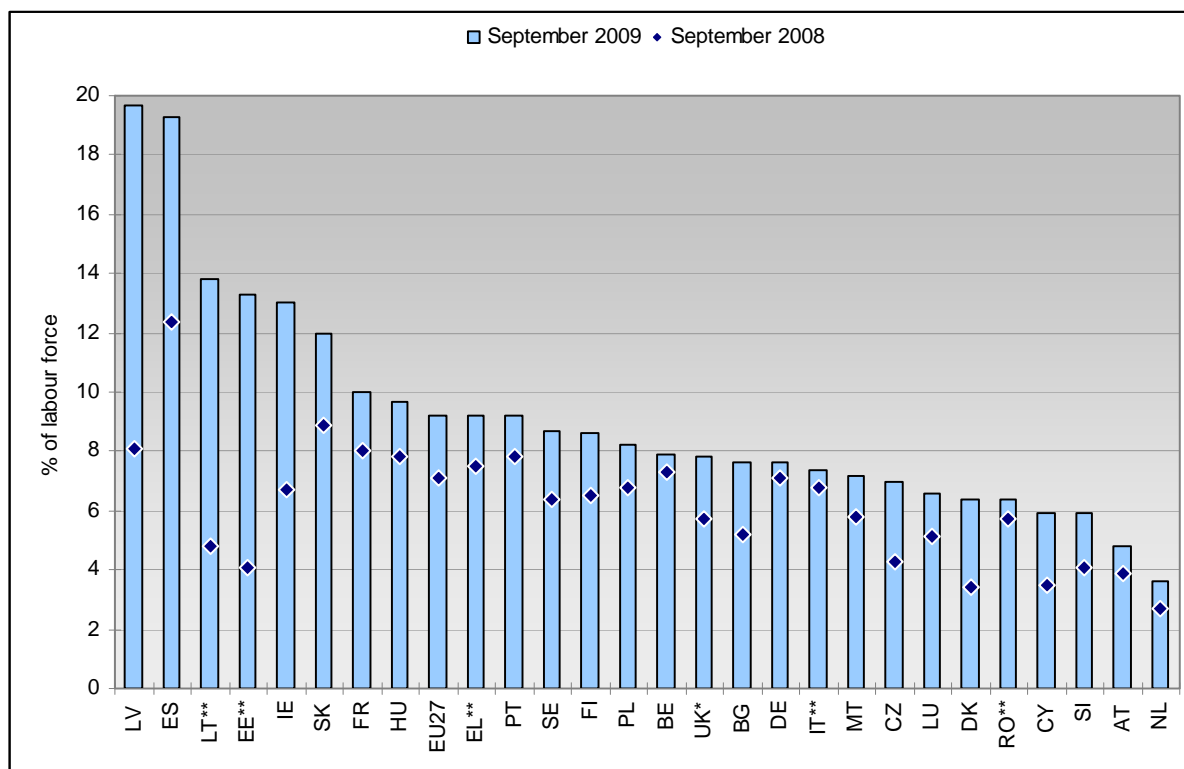


*Source: Eurostat, national accounts. Data non-seasonally adjusted for change on prev. year.*

### *...but the rise in unemployment has been restrained so far*

Despite clear signs of deterioration, so far the European labour market has held up relatively well given the abruptness of the economic downturn. Unemployment has risen (Chart 2), but by less than might have been feared given the strength of the recession and the sharp declines in confidence. For example, despite the sharper economic downturn and stronger falls in business confidence in the EU compared with the USA, by September 2009 the unemployment rate in the EU had increased by 2.1 percentage points compared to one year earlier, while in the USA it had risen by a more marked 3.6 percentage points. Nevertheless, the unemployment rate in the EU has remained on an upward trend since spring of last year, and by September 2009 had increased to 9.2%, a rise of 2.5 percentage points compared to spring 2008. Total unemployment was up by over a third (38 %): an increase of 6 million to 22.1 million,

Chart 2: Unemployment rates for EU Member States



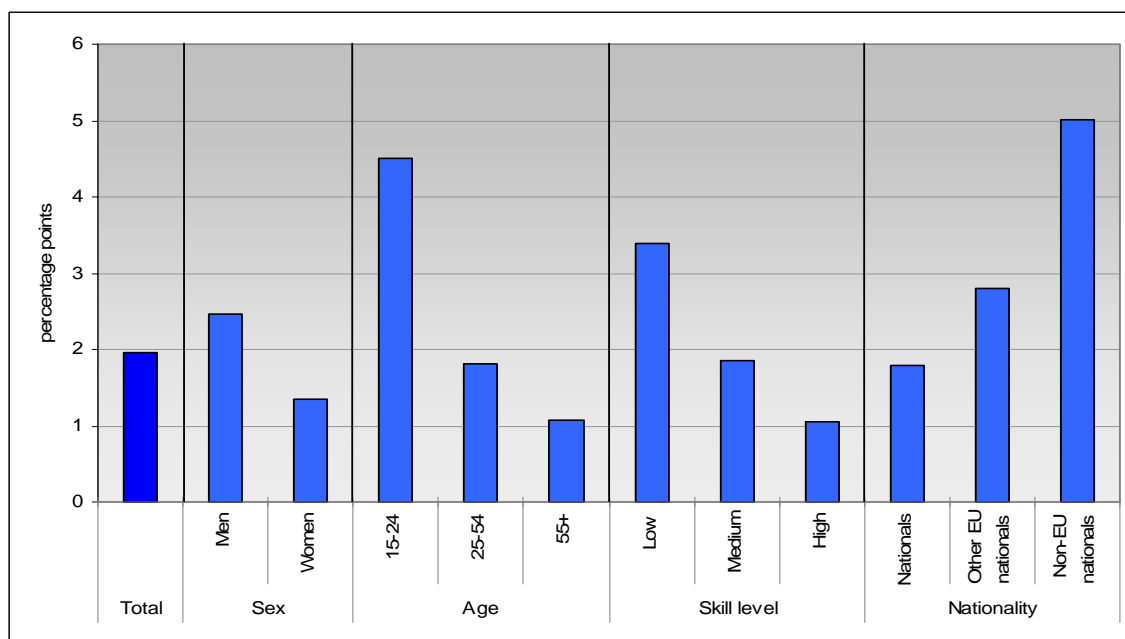
Source: Eurostat, series on unemployment. Data seasonally adjusted.  
 Note: Data for UK July 2008–July 2009, EE, EL, IT and RO 2008 q2–2009 q2.

**...with young people, the low-skilled, migrants, and among these those in temporary employment, so far most affected...**

The crisis is affecting men and women differently. Initially men have been more affected by the downturn than women, since many of the sectors hit hardest by the crisis are predominantly male-oriented in terms of employment.<sup>1</sup> However, female employment has also been severely affected during recent months reflecting an extension of the crisis to other sectors, more gender-mixed than the ones first hit. There has also been a continued strong rise in unemployment among young people, with young men being particularly affected, highlighting a rising need for support to tackle youth unemployment. Also most affected have been the low-skilled and migrants with low qualifications, which is partly a reflection of the sectors and occupations which have been most at risk in the downturn, such as construction and the low-skilled manual and elementary occupations. In terms of type of employment, those in temporary labour contracts have been relatively most affected by job losses. All these are traditionally the most disadvantaged groups in the labour market, and the current downturn has made their relative situation even worse.

<sup>1</sup> 'Growth, Jobs and Social Progress in the EU', The Social Protection Committee, September 2009

Chart 3: Rises in unemployment rates by sex, age, skill level and nationality, 2008q2–2009q2



Source: Eurostat, EU Labour Force Survey. Data non-seasonally adjusted.

**...and labour market conditions still likely to get worse before they get better**

Despite the encouraging recent economic signals, the full impact of the economic crisis on labour markets is, at least partly, still to be faced. While overall labour markets have proven to be quite resilient, the EU is still expected to lose some 7.5 million jobs over 2009–10, with unemployment potentially reaching around 10.3% by 2010, up more than 3 percentage points on 2008 levels. Historical experience shows that employment reacts to economic conditions with a certain lag, and most forecasts suggest that, while recovery seems already underway, economic growth will remain moderate for several years. The main reaction to the sharp downturn in economic activity in autumn last year only started to take effect in the course of 2009, and labour market conditions can be expected to worsen for some time even after the resumption of economic growth.

Signs point to substantial labour hoarding, given that most of the adjustment so far seems to have been in terms of productivity declines rather than employment losses. Another adjustment mechanism to the slump in demand and the economic downturn has been through wage concessions in return for employment stability.

Overall, the EU labour market has adjusted to the crisis mainly through reduced labour productivity rather than through employment contraction: in Austria, Belgium, Germany, Italy and the Netherlands, almost all labour market adjustment has been through falls in productivity, with hardly any reduction in employment. The increase in labour hoarding reflects both firms' perceptions that part of the decline in production is temporary (and they will accordingly seek to avoid destroying firm-specific human capital) and public policy efforts to contain rises in unemployment, such as through short-term working arrangements.

However, the decline in output combined with labour hoarding has led to a significant increase in unit labour costs. Unless labour productivity returns to more normal levels, unit

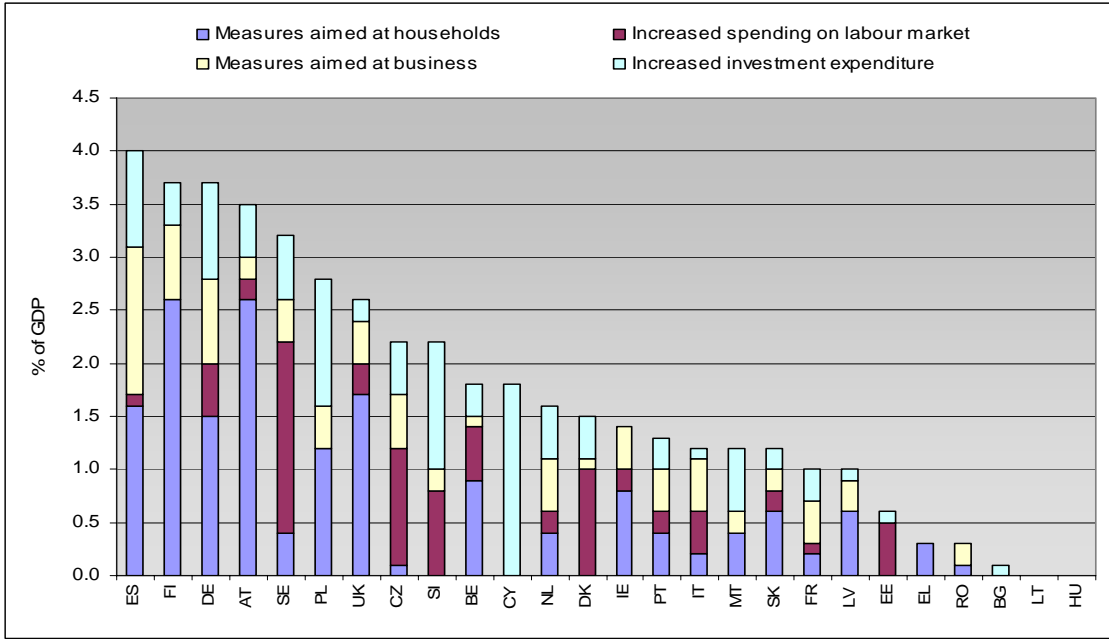
labour costs decline and firms' price-competitiveness improves, there is a significant risk of unwinding of this labour hoarding in coming months, leading to a further worsening in the unemployment situation, unless economic activity picks up noticeably.

**2. THE POLICY RESPONSES SO FAR**

*Fiscal stimulus packages and National Recovery Plans include employment measures<sup>2</sup>...*

The EU and its Member States, including central banks, have taken very significant policy action in face of the severe crisis. National Recovery Plans include provisions for employment, education, training and social policies. The total EU-wide stimulus package in Member States' recovery programmes is significant, amounting to 1.8% of GDP (Chart 4). The situation in Member States is diverse both in terms of the scope of stimuli packages and in terms of the effect of the crisis on growth and unemployment; some have been particularly hit by the crisis, such as Latvia and Lithuania, and have had to resort to massive budget consolidation programmes. Measures taken to support a proper functioning of the labour market and raising household purchasing power represent almost half of the recovery measures introduced by Member States. Austria, Belgium, Finland, Germany, Spain, Sweden and the UK have provided the largest fiscal stimulus to measures in these two categories.

*Chart 4: Overview of funding of recovery measures in EU Member States' recovery plans*



*Note: In the case of HU a gross funding of 1,45% is reported*

*Source: Commission services*

<sup>2</sup> The Commission will continue to monitor the response to the crisis in close cooperation with the Employment Committee, Social Protection Committee and Economic Policy Committee. A more elaborate overview of employment measures taken by Member States is available at: <http://www.eu-employment-observatory.net/resources/meetings/MISEPSwedenSummaryTables.pdf>

*...with Member States' employment measures focussing on the three agreed EU priorities...*

The employment policy response has covered the three priorities agreed by the European Council: maintaining employment, creating jobs and promoting mobility; upgrading skills and matching labour market needs; increasing access to employment and supporting households.

Overall, EU labour markets have in the first instance reacted by adjusting production and aggregate working time to counter the slump in demand rather than reducing employment levels. Short-time compensation programmes whereby employers can apply for temporary state assistance to top up the wages of workers working reduced hours, have protected European jobs from the initial impact of the recession. Indeed, the relative resilience of the EU labour market to date reflects in part the increased use of these internal adjustment measures (e.g. short-time working schemes and shorter working hours, temporary closures etc.) intended to preserve existing jobs while raising the employability of workers, including the most vulnerable through enhanced training programmes (CY, DE, ES, HU, IE, IT, LT, NL, AT, PT) and to support transitions between jobs (CY, CZ, ES and the NL). These arrangements have been most effective when they have included a provision making eligibility conditional on pre-specified criteria, one of which may be their coupling to work-related training to improve the employability of workers and ease their possible transition to new jobs, as for example in CZ and NL, where training has been made compulsory for all workers on short-time, but also in AT, BE, DE, HU. Stricter conditionality imposed on firms, e.g. in AT, HU, NL and SI, should also limit the risks of deadweight losses or of prolonging the moment of the sometimes inevitable restructuring of a company/plant.

Training opportunities and incentives have been expanded in most countries in the face of the crisis, with on-the-job training increasingly recognised as a key tool for improving the employability of those already in employment. To better address labour market needs, modernising and improving the administrative capacity of Public Employment Services has been a central focus for a number of Member States. Several national PES (e.g. UK, NL, BE, DE, FI, SE) created special early intervention schemes – often in partnership with social partners, municipalities and other labour market stakeholders. These were aimed at ensuring quick and secure transitions to those at risk of redundancy and thus at preventing long-term unemployment.

As part of their recovery packages many Member States have taken action to support the income of their most vulnerable citizens e.g. by increasing the level of minimum income or minimum wage, extending the coverage or duration of unemployment benefits, reinforcing other social benefit, or introducing tax rebates or exemptions for specific groups. Further, several are investing in their infrastructure for healthcare, long-term care, childcare or social housing. This has the twin aims of promoting employment and of improving access to social services for everyone including the most vulnerable. This is particularly important in order to support female employment and gender equality and to prevent a long exit from the labour market for some workers as during previous recessions.

A range of measures have been taken to support the active inclusion of those furthest from the labour market, and to promote the employment of those most at risk of exclusion: strengthening Public Employment Services to allow for more individualised support (BG, DK, DE, EL, ES, FR, LT, NL, PT, AT, SI, UK); expanding access to training (BG, CZ, DE, EL, FR, FI, IE, LT, PT, UK); subsidising employment for those furthest away from the labour market (FR, HU, LT), and promoting specifically the employment of people with disabilities (ES, RO).. Temporary rebates on social security contributions to boost labour demand during



the crisis have been introduced in several Member States; specific measures are targeted at older workers and aim at avoiding the use of early retirement schemes (PL, PT).

### **3. POLICY FRAMEWORK**

The three priorities identified by the European Council remain the right policy framework:

#### ***Maintaining employment, creating jobs and promoting mobility***

Although the immediate and longer term employment impacts of the stimulus and recovery measures are not yet assessed in detail, it is clear so far that they have proving effective in curbing the rise in the unemployment rate in several countries, particularly as concerns Short Term Work Arrangements (STWA). Evidence shows that measures will be most effective if designed with the involvement of social partners, and that stimulus expenditure should not be delayed by complex application procedures.

Given the expected further raise in unemployment, STWA schemes can continue to serve their purpose, over the short-term, provided that they are effectively temporary and well targeted, and only applicable to firms where the demand drop can be argued to be due to exceptional and temporary circumstances. Because of changing labour market conditions, the eligibility criteria, durations and budgetary specifications of these schemes must be reviewed every 6 months allowing for improved targeting and resource management. Moreover, since they may lead to companies getting massively overstaffed, short-time measures need to be complemented by measures supporting employability and easing labour market transitions.

Looking at consistency with long term goals, STWA provide security related essentially to a worker's current job: the security is lost upon leaving the protected job. In line with the longer-term flexicurity approach, it is crucial to provide more general employment security, allowing for people to move to more productive parts of the economy if so needed. A conceivable way forward is to combine STWA with training, and to introduce or extend a system of in-work benefits or tax credits. Given the depth and nature of the crisis, it is very likely that considerable restructuring will be necessary as the economy emerges from the crisis (e.g. construction, financial services, automobile industry). This suggests that there might well be a trade-off between unemployment today and more redundancies at later stage, particularly if the recovery is slow to materialise.

Improving the situation on the labour markets also requires enhanced efforts to support job creation. A number of Member States have already introduced financial incentives and hiring subsidies to create or sustain job places for particular groups of workers. Start-ups and investment in business expansion can be facilitated by a reduction of red-tape and administrative requirements for companies, and by a greater availability of funding and assistance services for new entrepreneurs and companies. Incentives to invest in innovative and expanding sectors (such as green jobs and also white jobs) should be considered; similarly, the social economy is an important source of job creation as it is less dependent on the business cycle and often provides labour intensive and socially useful services.

### ***Upgrading skills and matching labour market needs:***

With increasing unemployment and decreasing job vacancies, it is essential to have effective activation systems in place. Greater emphasis on job seekers' responsibilities should go hand in hand with the provision of high quality job search services and programmes and an adequate replacement income, especially for people with very poor employment prospects.

Tackling unemployment requires strengthened active labour market policies, better targeting of programmes and services, and an enhanced capacity of Public Employment Services (PES). The objective is to ensure that individuals' itineraries are secure (development of skills, employability and social protection safety nets), and to guarantee the security of recruitment for businesses, while coping with an increased volatility in the labour market and threat of (mass) redundancies. For men and women facing difficulties in gaining new employment, the "training first approach" should be considered. For the entire workforce, upskilling and re-skilling is crucial to ensure adaptability and employability in uncertain times. Education and training providers should be responsive to the increasing needs of the labour market in times of crisis. Active labour market policies must also address the needs of young people, for whom the lack of work experience is often the main obstacle to access support schemes and find the first employment.

Occupational, sectoral and geographic mobility can facilitate transitions into new jobs and help prevent long-term-unemployment. An early intervention approach requires constant cooperation between PES and employers, to intervene before actual redundancies take place. Enhanced co-operation between employment services, public authorities, training organisations and above all employers and social partners is also of key importance to provide adequate services, including qualification and redeployment programmes and apprenticeships for the young. This co-operation is also indispensable to prepare the workforce for the new jobs of tomorrow, especially in expanding sectors.

### ***Increasing access to employment and supporting households:***

One key element determining increased access and attachment to work is in the design of taxation and benefit system. Complementarities between active labour market policies and tax and benefit systems must be strengthened to this effect. Features of tax and benefits systems such as the so-called unemployment traps or joint family taxation may discourage secondary earners and main carers from (re)entering or remaining on the labour market, notably on a full-time basis. In order to maintain the labour market attachment of older workers, opportunities for early labour market exit must be avoided. Reducing non-wage labour costs could be an instrument in particular to help people with multiple disadvantages (low skilled, young and older workers) to stay in the labour market.

Increasing the income tax thresholds below which no taxes are to be paid can lead to a substantial tax relief most relevant for and targeted to low income earners; Sweden has introduced tax reliefs on income from gainful employment. This is consistent with long term goals of making work pay, and is expected to have positive long term employment effects.

While the reduction of non-wage labour costs is an important measure to increase but also maintain employment, the risks of deadweight costs are high: reducing taxes, social security contributions and other non-wage labour costs for employers should be welcomed only if

these measures have an immediate effect on the decision of an employer to hire or maintain staff - for example by providing subsidised part-time contracts with more attractive conditions for companies. If there is no immediate effect on hiring, other temporary government spending of equal value aiming to support increasing employment directly in labour intensive sectors confronted with skills bottlenecks (e.g. in the care sector) would be more effective in the short term.

Considerable attention to supporting household incomes will be necessary until the recovery has taken hold, although Member States' capacity clearly differs in this regard. Benefits are in some cases too low, or their duration very limited in time. On the other hand, the design and generosity of benefits need to be properly defined in order to limit disincentive effects to take up work for beneficiaries. Workers with fixed term and part time contracts should also benefit from insurance against unemployment and other social risks. More attention is also needed to the self-employed who often have no insurance against the loss of work, and to young people who are in a particularly difficult situation.

Direct social transfers are essential to mitigate adverse social impacts, since they reach those in most need very quickly and provide a direct positive impulse to the economy; governments can use existing channels to get the benefits to households, and therefore criteria for targeting can be readily used. Benefit design should support activity and adaptation to change, thereby contributing to better labour market performance when the economy recovers. However, government income transfers to households draw heavily on scarce funding, often directly increasing national debt levels. These transfers can also create benefit dependency and result in a reduction in labour supply and subsequently create inefficiency and malfunctioning of labour markets. Therefore benefit spending should decrease as the labour market recovers.

Workers with temporary contracts have been laid off massively in countries which have an imbalance between precarious short term contracts and permanent contracts. To step up rights for this group of workers, Member States have taken different approaches: some have limited the maximum duration of temporary contract up to 2 years as part of a new anti-crisis regulation; others have extended the maximum duration of temporary contracts beyond 2 years. Within each context, the key point is that social partners and authorities should work together to ensure that as many workers as possible are retained in the labour market, and that employment legislation and contractual arrangements ensure adequate rights and obligations for employees and employers. This implies addressing segmented labour markets, through reforms in line with the "flexicurity" approach that shift the focus from protection on the job to employment security in the market.

#### **4. FIVE KEY ACTIONS FOR 2010 AND BEYOND**

The severity of the current recession justifies continuation and reinforcing labour market policies and providing income support for those most in need even if GDP slowly picks up next year as expected. Once the economy starts growing the emphasis will need to progressively shift from short term crisis measures to structural labour market reforms aimed at stimulating potential growth and on bringing people into the labour market, as recently stressed by the Employment Committee<sup>3</sup>. The latter also requires an increase in the effective

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<sup>3</sup> "Bringing more people into the labour markets" EMCO ADHOC/18/201000

retirement age by enabling and motivating people to work longer through labour market policies promoting better age-management practices in work places and ambitious reforms of work incentives in pension systems. To this end, flexicurity and active inclusion provide an integrated framework that allows Member States to take up an adequate mix of priorities in line with their labour market and social situations and challenges. Flexicurity strategies which ease transitions into work, eliminate obstacles to participation and enable upward transitions within the labour market are particularly relevant. In line with the EU Common Principles of flexicurity, five key actions are vital to mitigate the negative effects of the crisis on employment and to return to sustained employment growth when the crisis is over:

**1. *Invest in effective labour market measures and skills to avoid long-term unemployment***

The top priority is to invest in effective labour market measures, adequate social protection and relevant education and training provisions, to prevent unemployment from becoming structural. Keeping men and women in work widens the contributors' base for tax and social security, and thus contributes to sustainable public finances, macro-economic stability and well functioning social protection systems. Employment services must be enhanced to reach out to all those in need, including the young and workers threatened by redundancies. Interventions should be timely and targeted, and seek complementarily with other measures aimed at making work more economically attractive and rewarding to secure transitions, and reduce inactivity and the duration of unemployment spells. This should be coupled with measures aimed at enabling and motivating people to work longer through labour market policies promoting better age-management practices in work places and ambitious reforms of work incentives in pension systems. The best results are obtained by personalised support, with a focus on job search for people with high employability potential and more comprehensive, tailored assistance to those having more difficulties. Unemployed people and workers on short time and in declining sectors should be offered skills upgrading and retraining programmes. These programmes should be targeted, so that they match the future skills needs of the labour market and prepare for the recovery.

Member States are encouraged to make better use of the existing European funds, particularly the ESF and ERDF, to support recovery measures including strengthening the efficiency and capacity of Public Employment Services, to improve the efficiency and effectiveness of the services offered to those seeking employment and to workers and companies under restructuring.

**2. *Help businesses create new jobs***

It is essential to promote job creation, by facilitating start-ups and strengthening services to assist new entrepreneurs and companies. There is in particular a high potential for business creation among women which needs to be tapped. Efforts to increase access to finance and the availability of credit should continue, as well as incentives to companies to create or sustain job places and offer apprenticeships. An enhanced and constructive dialogue with social partners is crucial also to ensure that wage developments are in line with productivity and sectoral and local labour market conditions.

The ESF, the ERDF and other EU funds can be better used to promote entrepreneurship, self-employment and support for SMEs and micro-enterprises. Financial incentives for innovation and training can help, on the one hand to explore the potential of expanding sectors, new technologies and new ways of doing business; on the other hand, to develop the social economy.

### **3. *Preserve jobs through flexible work organisation***

With rising unemployment, internal flexibility is an essential instrument to preserve jobs: in 2010 short-time working arrangements can still be seen as an efficient way to maintain the employment of workers who would otherwise be laid off, including in SMEs. These schemes can mitigate the social impact of the crisis in the short term, save considerable firing and (re)hiring costs for firms and prevent the loss of firm-specific human capital. However, these arrangements must be designed in an economically sound and sustainable way: they should be combined with (re)training, apply only to companies with strong fundamentals, and their duration and eligibility criteria should be subject to regular review. In sectors and companies confronted with structural losses in external competitiveness, measures must be focussed to equip the workforce with the skills required for new jobs to facilitate the transition into growing activities.

### **4. *Support young people and those most affected by the crisis***

The greatest threat from the rise in unemployment lies in the prospect of permanent exclusion. It is already harder for young people, notably those with low qualifications and for people at the margins, to (re-)enter the labour market. Measures to support the employment of vulnerable groups, particularly making work economically more attractive, in-work benefits, targeted reductions of non wage labour costs and other subsidies, should be stepped up. For the young in particular, places for work experience and apprenticeships, innovative learning methods such as project-based learning, can ease the transition from school to work. Flexible learning pathways can help to acquire progressively new skills and qualifications, to step up in the education and training system and to move up in and on work. For low-skilled and older unemployed, the key priority is adequate training to maintain their employability. Permanent exclusion can be a particular risk for women especially those having care responsibilities since they already represent the majority of inactive persons, involuntary part-timers and secondary earners. Specific measures are needed in order to avoid exit of the labour market and exploit the full potential of female labour reserve. Job-seeking and income support initiatives for vulnerable job-seekers must be better coordinated, and their impact closely monitored to avoid excessive dead-weight and negative impact on social protection schemes. The business models of Public Employment Services should evolve, with effective co-operation with other governmental, non-governmental and private institutions (e.g. municipalities, NGOs, chambers of commerce, training providers, agencies offering employment services) and above all with companies and social partners, to build public-private partnerships.

### **5. *Improve the situation of people on non-standard contracts***

The rise in unemployment and its subsequent social cost is falling disproportionately on workers on temporary and other non-standard contracts, who often have

inadequate coverage by unemployment insurance systems and active labour market policies (as their provision is usually linked to benefits). In the current context it is essential to improve employment security and to support transitions. It is also key addressing segmented labour markets, through reforms in line with the "flexicurity" approach that shift the focus from protection on the job to employment security in the market. Social dialogue can help ensure that as many workers as possible are retained in the labour market, and that social security and employment legislation provide adequate rights and obligations for employees and employers in all type of contracts.