RECENT UNEMPLOYMENT TRENDS IN EUROPE: STYLIZED FACTS AND ECONOMIC POLICIES

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ABSTRACT

Questo elaborato illustra i recenti trend della disoccupazione in Europa, i fattori che hanno causato l’aumento differenziale nei tassi di disoccupazione nei Paesi membri dell’UE registrati all’indomani della globale crisi finanziaria del 2008 e le politiche economiche proposte per ridurre gli elevati tassi di disoccupazione, incluso il Piano di investimenti per l’Europa recentemente adottato dalla Commissione Europea. La descrizione si basa sulle opinioni teoriche ed empiriche presentate nell’apposita letteratura così come sui dati statistici disponibili. Per quanto riguarda le politiche per ridurre la disoccupazione, in particolare, esse dovrebbero concentrarsi principalmente sull’aumento della domanda aggregata, stimolando i livelli più alti di investimento nell’economia reale. Infatti, gli obiettivi del Piano mirano bene i fattori che influenzano l’aumento della disoccupazione, a patto che esso riesca a mobilitare con successo gli investimenti del settore privato, e che i criteri per l’allocazione del fondo di investimenti siano tali da raggiungere i Paesi con i tassi di disoccupazione più alti. Sul lato dell’offerta, invece, si evidenzia la mancanza di consenso sull’efficacia delle politiche volte a migliorare la flessibilità del mercato del lavoro.
INTRODUCTION

A superficial look at any relevant paper addressing economic issues, both scientific and aiming at wider public, is enough to realize that Europe has not yet recovered from the recession started with the global financial crisis in 2008. Whereas a number of economic difficulties has been identified and analysed, the most worrying problem from human perspective, and from the perspective of long-term economic development, is loss of numerous jobs and rising unemployment. Literature addressing the problem ranges from description of trends in Europe as a whole as well as in particular EU member states, to attempts to look at the causes of high unemployment, with an ultimate aim to propose policies to decrease unemployment rates. The choice of the EU and nation states policies to affect unemployment sustainably depends on whether the unemployment drivers are predominantly cyclical or structural. It further depends on whether a particular combination of factors affecting unemployment prior and in the aftermath of the crisis differs among the EU member states.

The most obvious suspect for the increase in unemployment are the factors affecting aggregate demand and causing negative (and subsequently too slow) economic growth. With peak of the recession in 2009, one would expect economic recovery would have taken place by now and would have translated into lower unemployment rates, if not by the “natural” mechanisms of economic adjustment, then with the help of monetary and fiscal policy instruments. However, analysts emphasize that, with almost zero inflation rate and extremely low interest rates, euro area monetary policy instruments have been almost exhausted, with no space for much further manoeuvre, and with no noticeable effect on the economic growth recovery and job creation in particular (especially in some EU member states). Some analysts point that the EU fiscal policy instruments for boosting of economic growth have been constrained as well by the unfavourable combination of budget deficit limits, imposed by EU rules, and the fact that countries, which were hit by the recession most severely and which have the highest rates of unemployment, also have the highest rates of sovereign debt. This prevents them from either lowering taxes or/and increasing government spending, which would be policy reaction expected in times of economic recession.
Different European countries reacted to the crisis with the various intensity of unemployment increase. Even after accounting for countries' differences in the crisis effect on economic growth, differences in unemployment rates still persist. This suggests that, in addition to demand side factors, there have been other factors underlying increase in unemployment as well as explaining persistent high unemployment levels, both before and in the aftermath of the crises.

In the first part of this paper (in Chapters 1 and 2) we describe unemployment developments in Europe, prior and in the aftermath of the 2008 crisis and, in the light of the relevant literature, explore the factors affecting differential increase in unemployment rates in the EU member states following the crisis. Chapters 3 and 4 look at the implications of the combination of factors driving unemployment increase for particularly worrying phenomena of high youth unemployment and long-term unemployment in Europe. Chapter 5 discusses the policies proposed (and some already implemented) to decrease unemployment and assess how well they target unemployment drivers presented in the Chapter 2.

The most recent agenda for increase of economic growth in Europe, which also promises to create new jobs and boost employment, is Investment Plan for Europe. It was announced by Jean-Claude Junker, President of the European Commission, in November 2014. The Plan aims at mobilizing public and private investments of at least €315 billion, over a three year fiscal period (Jan. 2015 – Dec. 2017) and directing it to the “real economy”.

An observable impact of the plan is expected in 2016. Since we still do not have a detailed information about implementation of the Plan, in particular related to the selection of projects to be financed and their sectorial and countries' allocation, it is rather difficult to assess the Plan's effects on GDP growth, job creation and reduction of unemployment in the countries where most of the unemployment increase took place. However, it is possible to hypothesize about it by comparing declared intentions of the Plan, in as much detail as it has been published by now, with the results of the exploration of factors driving unemployment increase.

Thus, the last chapter of this paper (Chapter 6) sets to explore the conditions under which recently proposed Investment Plan for Europe may translate into jobs creation and decrease unemployment in Europe. This task is related to several assumptions. The first is that increased
unemployment rate in the EU (and particular EU member states) is significantly related to the investment halt recorded since 2009. The second is that the Investment Plan for Europe will actually succeed in mobilizing investment and third is that investment projects and funds would be allocated to sectors and countries which currently contribute the most to the high level of the EU unemployment. The closest we will come to a “prediction” of the Plan's effect will be by reporting the results of the ILO simulation of employment impact of the Plan, under various scenarios of investment fund allocation.

1. UNEMPLOYMENT RATES IN EUROPE

The problem with high unemployment rates in EU (and more specifically in the euro area) addressed in this paper refers to the period since the wake of global financial crises in about Western Europe lost slightly less than 7 million jobs 2008 between 2008 and 2013. In terms of unemployment, there have been over 9 million more unemployed in 2013 than in 2008 (Eurostat data). “Unemployment, youth and long-term unemployment in particular, reached unprecedented levels, especially in the euro area (EA) periphery.” (IMF 2014, Chapter 5, p. 37)

However, a description of European unemployment trends and characteristics, as well as an attempt to point at its possible causes should at least sketch its main features prior to the major recession. From very low unemployment rate of 2% in the 1960s, European unemployment started increasing in the 1970s. It increased further in the 1980s, to reach almost 11% in mid 1990s. Since then, unemployment rate for EU as a whole has been decreasing to about 7% by the end of 2008. Following the financial crisis in 2009, it has escalated to around 11% (and 12% in euro area) in the second quarter of the 2013. (European Central Bank, October 2012; Blanchard, November 2015) “Despite some encouraging signs of recovery that emerged in 2011, only three European countries (Germany, Malta and Poland) have observed unemployment rates below pre-crisis levels...In some instances, unemployment rates have increased by more than 5 percentage points in the last three years alone, notably in Cyprus and Greece.” (ILO 2015, p. 9) The average unemployment rate for EU, recorded in the third quarter of 2014 was 9.7% – 3% above the level in the third quarter of 2007.
Based on the trend in Europe unemployment rates by 2004, Oliver Blanchard pointed at four major features of European unemployment (Blanchard 2004). Firstly, he stated that, looking at the long-term trends, high unemployment is not a European trait. Secondly, he noticed that the evolution of the average European unemployment rate hides large cross-country differences. Thirdly, he emphasized that the increase in European unemployment reflects an increase in duration rather than an increase in flows in and out of employment. Fourthly, given the steady rates of inflation in Europe, he suggested that, periodic cyclical movements in unemployment rates notwithstanding, “the broad movements in the unemployment rate have reflected movements in the natural rate of unemployment”.

1.1 Countries differences

The changes in unemployment rates since the onset of the global financial crisis have been remarkably different among European member states. Only some of the countries experienced very large surges in unemployment. “Between 2008 and 2012, the unemployment rate increased to 25.0 percent from 11.4 percent in Spain, but declined to 5.5 percent from 7.5 percent in Germany. The contrast is even starker in the employment data. Between 2008 and 2011, employment dropped by 14 percent in Ireland, but increased by 2 percent in Poland and Germany” (IMF 2014, Chapter 1, p. 1). With such big differences in unemployment rates changes we can say, with the Blanchard, that “talking about “European unemployment” is indeed misleading” (Blanchard 2015, p. 6).

Indeed, when talking about drop in employment in EU in absolute numbers we are actually talking about decreased number of employed people in Spain, Greece, Italy, Portugal and Ireland. Increase in number of unemployed persons from 2008 to 2013 could be largely accounted for by increase in numbers of unemployed in Spain, Italy, Greece, France and Portugal. If this is so, looking for causes of so-called EU unemployment and thinking of policies to address the problem, including newly released Investment Plan for Europe should primarily have these countries in mind1.

Next five graphs plot the unemployment rates for all EU member states from 1990 to 2015 (based on Eurostat data). On the first graph, the unemployment rate trend since 1990 is plotted for the

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1 In the rest of the paper we will refer to these countries as either southern Europe or Europe periphery.
European countries that had unemployment rates below 6% from around 2000 to the wake of the financial crisis in 2007/2008. Luxemburg and Austria had low unemployment rate in the entire observed period, and registered almost negligible increase following the financial crises. Denmark, Netherlands and UK came to a plateau in 2000s by decreasing their unemployment rates that picked in 1993/1995. Following 2008 they experienced an increase of unemployment rates by about 3%, however the rates did not exceed 8% and this increase was quickly contained. Although Ireland had similar rates in the period between 2000 and 2008 (below 5%), it had a history of very high unemployment rates of above 15% in 1993 and 1994, and its unemployment rate increased again following 2008 to 15% in 2012 and 2013. A remarkably sharp increase in unemployment rates occurred also in Cyprus, from less than 4% in 2008 to 16% in 2014.

Graph 1: *Unemployment rates in European countries % Total*

The second group of countries presented in Graph 2 consists of countries with medium unemployment rates, above 6% (except Portugal), but below 9% (except Germany) in the period between 2000 and 2008. Among these, Portugal and Italy (and to some extent France) experienced a sharp increase in unemployment rates following the recession. Germany, on the
other hand, decreased its unemployment from as much as 11% in 2005 to 5% in 2014. “Some authors have noted that German unemployment rates declined after the crisis, because firms hoarded labour given their prior experiences with labour shortages. Instead of layoffs, German companies resorted to a decrease in average hours worked per worker, facilitated by reforms that increased working-hour flexibility at the firm level in the form of the short-time work scheme (Kurzarbeit) and by much greater wage bargaining flexibility.” (Reisenbichler and Morgan 2012. In: Benerji 2014, p. 11)

Graph 2: Unemployment rate % Total (continuation)

In the third graph we presented trends in unemployment rates for Greece and Spain, countries with highest rates in Europe for most of the years preceding the 2008 recession. Their unemployment rates exploded after the 2008 to reach more than a quarter of their labour force.

Source of Data: Eurostat
Last update: 30.06.2015
Date of extraction: 18 July 2015
The last two graphs (Graphs 4 and 5) present former socialist countries which more or less completed transition to market driven economy by 2000. We split them in two groups. The first is made of countries with the rates lower than 9% prior to the 2008 recession. Among them, Czech Republic and Romania maintained relatively low rates after 2008. Slovenia and Hungary experienced large increase in unemployment rates since then. Hungary, however, managed to return the rate to its 2009 level, and Slovenian rate is still below 10%.

The second group of former socialist countries contains the countries with very high unemployment rates in 2000, but which steeply decreased to well below 10% until the wake of the 2008 recession. In almost all of these countries (with the exception of Poland), the unemployment rates steeply increased again, following the crisis. However, the rates dropped after 2010, with the exception of Slovakia and particularly Croatia (17% unemployment rate in 2014).
Graph 4: Unemployment rate % Total (continuation)

Source of Data: Eurostat
Last update: 30.06.2015
Date of extraction: 18 July 2015

Graph 5: Unemployment rate % Total

Source of Data: Eurostat
Last update: 30.06.2015
Date of extraction: 18 July 2015
2. FACTORS AFFECTING UNEMPLOYMENT AFTER 2008

2.1 Employment and GDP growth

If there is economic growth downturn, demand for labour falls and unemployment increases (provided that there is no strong employment protection legislation preventing layoffs, and no change in wage levels). Long-term economic growth trend in Europe (measured by GDP levels) compared to the US is such that after GDP levels increasing steeply following the World War II, and being closest to the US rate in 1980 (about 90% of U.S. per capita GDP), euro area output today stands at about 70% of the US output, with Greece, Ireland, Italy, Portugal, and Spain measuring less than 60% of that mark (IMF 2014, Chapter 1). The EU GDP fell sharply between 2007 and 2009, in the first phases of the global economic recession. After 2009, GDP levels for entire EU-28 have improved to nearly attain pre-crisis level in 2014.

However, EU's recovery seems to be rather slow in comparison to other major economies', as well as when compared to the EU's previous recession spells. “Economic growth in the 28 European Union Member States (EU-28), at 1.3 per cent in the second quarter of 2014, remains well below the pre-crisis growth rate of 2.7 per cent (average between 2000 and 2007)” (ILO 2015, p. 3). Moreover, the growth outlook for 2015 is deteriorating, with the European Commission forecasting growth in gross domestic product (GDP) at 1.5% (compared to 2% forecast in 2014). Most of the revision of expected growth refers to eastern European countries, but the outlook in France and Germany is also cut by half (from 2 to 1.1%). (ILO 2015)

Turning to the relation of economic growth (measured by the GDP level) and employment rates, IMF staff estimated that around 60% of change in employment rates in EU countries between 2008 and 2011 could be accounted for by a change in real GDP growth in that period.
A scatter chart of real GDP growth and employment growth between 2008 and 2011 presented in Graph 6 shows a strong correlation between the two. On one extreme is Latvia, with the largest decline in real GDP between 2008 and 2011, and one of the largest reductions in employment. On the other extreme is Poland, with the largest increase in real GDP during this period, associated with one of the best employment outcomes. Thus, one can claim that difference in employment and unemployment rates following the financial crisis among European member states could be accounted for by different extent to which the crisis affected GDP in these countries. Although most of the EU countries have been adversely affected by the global financial crises, not all of them have been affected equally to start with. Also, the extent and dynamic of the subsequent recovery differed substantially among the countries.

Factors affecting economic growth (measured by GDP) could be divided into demand side and supply side factors. Demand side factors influence growth of aggregate demand (Y), which could be expressed as a sum of consumption, investment, government spending and net exports.

\[ Y = C + I(Y, i) + G + NX \]  

\(^{(2.1)}\)

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Accordingly, any increase in consumption \((C)\), investment \((I)\), government spending \((G)\) or net exports leads \((NX)\) to an increase in aggregate demand and economic growth, and vice-versa. The recent crisis is characterized by a drop in all factors influencing AD, to a various extent in particular countries. However, analysts identify the drop in investment as accounting for the largest proportion of the fall in GDP between 2007 and 2013.

In order to empirically establish the relationship between registered unemployment rate and the level of investment in a country, we plot data on the two economic parameters simultaneously for a number of selected countries. We chose Ireland, Cyprus, Greece, Portugal, Spain and Italy - countries which unemployment rates steeply rose and Austria and Germany - countries which rates remained stable.

Graph 7: *Unemployment rates and levels of investment (2000-2014)*
Low investment level in EU could be to some extent accounted for by the post crisis legacy. However, investment in the United States of America, have recovered by more than 2 percentage points and the unemployment rate has fallen by more than 3 percentage points since 2009. At the same time, investment in the EU-28 still remains well below pre-crisis levels and is considered too low to make a significant dent on unemployment. (ILO 2015)

“In the short term, weak investment slows economic recovery…In the longer term the lack of investment hurts growth and competitiveness. Weak investment in the euro area has a considerable impact on the capital stock, which in turn holds back Europe's growth potential, productivity, employment levels and job creation.” (European Investment Bank 2015)

Analysts point that restrained recovery in the EU after 2009 is largely the consequence of high level of public and private debt (IMF 2014, Chapter 2). To what extent EU countries differ in respect to the debt levels and how is the large debt created?
Graph 8: *Indebtedness in Euro Area*

The IMF staff, in their publication, explains development of high indebtedness in the crises worst hit European countries as follows. The countries that experienced the worse growth and unemployment outcomes during the crisis and “are still in the middle of deep recessions” (IMF 2014, Chapter 2, p. 11) are the ones that had the most rapid debt increases prior to the global financial crisis. The increase in indebtedness occurred after European periphery economies joined Economic and Monetary Union (EMU), which created an environment of “a rapid decline in borrowing costs and abundant global liquidity”. Because of expectations that under these condition “the periphery economies...would catch up with higher-income EMU countries”, large amounts of foreign capital flew to the European periphery. The inflow of foreign capital was welcomed at the time since it “helped compensate for losses in competitiveness before the crisis”. However, during and following the crisis, these countries experienced large difficulties to return and service their debts. These difficulties, in turn, arise out of several reasons. First, “the bulk of the inflows financed consumption and investment that yielded low returns, particularly in the nontradables sector, with limited impact on potential growth”. Second, “real appreciation following euro adoption favoured nontradables and reduced export competitiveness” (IMF 2014, Chapter 5, pp. 39, 48). Third, by relaying on borrowed money, these countries delayed necessary structural and labour market reforms, which left them unprepared for the crisis hit. Fourth,
“countries in need of adjustment are constrained by a common monetary and exchange rate policy, leaving them little space for manoeuvre”. Finally, countries with high private debt have also high government debts. Private sector improving of their balance sheets in these countries happens simultaneously with the governments improving their balance sheets by cutting spending or increasing taxes (in line with the proscribed maximum level of budget deficit in the euro area), thus “making the overall task daunting”. This is further aggravated by a halt in financing flows since “a fragmented financial sector with its own balance sheet problems amplifies the effect of private sector balance sheet stress on economic outcomes” (IMF 2014, Chapter 2, p. 11).

It seems that the more preoccupied private sectors and governments in European countries are with sorting out their finances, they are more likely to reduce the number of employees and less likely to invest and create potential for growth and job creation.

We have seen that observed differences in countries' employment and unemployment rates could largely be accounted for by differences in real GDP growth, in its turn largely resulting from a fall of investment levels, while countries faced with the need to improve their balance sheets. However, a part of the countries change in employment and unemployment rates following the crisis remains beyond the impact of differential GDP growth. (IMF 2014, Chapter 3; ILO 2015) “For instance, in some cases (for example Poland and Slovakia) GDP growth has far outpaced job gains, whereas in the odd EU country employment growth has surpassed GDP growth (for example in Germany between the beginning of 2008 and the second quarter of 2014, employment and GDP growth were equal to 1.0 and 0.8 per cent, respectively). Other countries have experienced a fall in employment more pronounced than the contraction in GDP (for example Ireland and Spain), while others have seen a relatively more pronounced fall in GDP than employment (for example Greece).” (ILO 2015, p. 5) It seems that in these particular cases some other factors are at play. In the rest of the paper we will shortly outline some of the factors analysed in the relevant literature.
There is plenitude of analyses of factors affecting differential impact of the 2008 crises on employment and unemployment rates. However, we report the findings of the IMF staff analysis (IMF 2014, Chapter 3) because it accounts for the observed differences by adding several factors in a single multivariate regression model trying to find the best model fit, so that it explains most of the observed differences. Authors found that the remaining differences in employment growth between 2008 and 2011, which cannot be explained by the differences in countries GDP growth (see Graph 6), could be accounted for by the changes in corporate profit shares in these countries. “...Countries that had sharp increases in profit shares had worse employment outcomes than would be expected given their output changes.” (IMF 2014, Chapter 3, p. 18) By contrast, profit shares declined in countries experiencing more moderate declines or even an increase in GDP and employment.

Graph 9: Change in Profit Share of Nonfinancial Corporate Sector versus Employment Growth Not Explained by Real GDP Growth, 2008–11.

Adopted from: IMF 2014, Chapter 3, p. 18

An interpretation of these findings builds on the previous account of the adverse economic growth in some European countries due to sharp increase in the corporate debt during the pre-
crisis capital inflow boom. This was often accompanied by a decline in profitability. When the financial crisis hit the firms which experienced excess debts, they tried to improve their financial situation. Most of them cut on investment and tried to raise corporate profitability and saving. “For a given a level of output, increases in profit shares - that is, declines in wage shares - can be brought about through either reductions in employment or reductions in wages.” (IMF 2014, Chapter 3, p. 18) In countries where reduction of wages was difficult due to wage setting procedures, and reduction of employment was easier (as was the case with countries with large numbers of employees on temporary contracts less protected by employment protection legislation) intentions to increase profit shares resulted in more unemployment.

2.3 Labour market duality

Frequently reoccurring theme when discussing the factors that had led to sharp increase in unemployment after the crisis, in some countries (such as Spain), is so called labour market duality. Labour market duality refers to a situation of coexistence of permanent and fixed term labour contracts in a country. Permanent contracts enjoy high level of employment protection (such as elaborated rules of employee dismissals), whereas fixed term (temporary) contracts are by far less secure. Such situation has been increasingly created in some of the Europe's countries prior to the 2008 crisis, with Spain being the most typical example. There, “strict protection in a secure part of the economy has encouraged employers to increase their labour forces by offering new recruits fixed-term contracts” (Horwitz and Myant 2015, p. 11). It is reported that in 2007, 88% of all new labour contracts in Spain were temporary. Similarly, in Italy and France 78% of all newly concluded contracts were temporary (OECD 2013; Myant and Piasna 2014).

Labour market duality is related to the sharp increase in unemployment following the crisis, in a way that when there is a downturn of economic activity, a part of the labour force employed on temporary contracts is relatively unprotected and can be quickly and dismissed (Horwitz and Myant, 2015).
In fact, data show that the “job losses after 2008 certainly did hit temporary workers much harder than those on permanent contracts.” This is, however, not a direct outcome of a need for corporate adjustment. We have already seen that when faced with a need to adjust to a fall of economic activities and in order to increase their profit shares, firms can also turn to wage reduction. In Spain, however, the space for that was rather limited by further institutional rigidities associated with permanent labour contracts. Analysis points that in Spain “collective agreements typically contain a strict schedule for wage increases, which outpaces the rise in productivity. For this reason...instead of coping with economic downturns by adjusting wage levels or reducing working hours per employee, Spanish companies simply lay off workers employed on temporary contracts. In this way...Spain responds to economic crisis through adjustment of employment rather than through application of internal flexibility, leading to the steep rises in unemployment rates.” (Horwitz and Myant, 2015, p. 17)

In addition to increasing the probability that cost-cutting measures in the corporate sector will result in employment cuts, dual labour markets also contribute to a number of other potential problems. They increase income inequality between the primary and secondary labour force, divide the society and lead to social exclusion of parts of population. Since most of the new
labour contracts are temporary and, as in the case of Spain, there is “the very low transition rate between temporary and permanent contracts such that fixed-term employees are trapped in a rotation of temporary jobs” (Horwitz and Myant 2015, p. 17), labour market duality makes access to decent jobs for young people extremely complicated and difficult. Finally, the threat of job loss hanging over employees on temporary contracts reduces willingness of both employers and employees to invest in on the job training and professional development.

Returning to the IMF staff multivariate regression model explaining the employment rates changes in 23 European countries between 2008 and 2011, we can conclude that labour market duality (in the model measured by the share of employees on temporary contract in 2007) is the third factor behind the large differences in employment growth. For a given a level of output and increases in profit shares, the remaining differences in employment growth could be accounted for by duality of labour market in a country. According to this model, variability in these three factors cumulatively account for almost 90% of differences in employment rates in the observed sample of countries.

Graph 11: Decomposition of Employment Growth, 2008-11.
2.4 Concentration of unemployment in cyclically sensitive industries

Another factor frequently discussed in the literature trying to explain excessive increase in unemployment in European periphery is sectorial distribution of employment prior to the crisis. Manufacturing, construction, and wholesale and retail trade are most frequently mentioned as sectors that tend to be more sensitive to the business cycle, so that the concentration of labour force in these sectors may result in more layoffs in times of economic decline. On the other hand, the information and communication technology sector and services (including education, health and public administration) tend to be protected from the business cycle downturns. In the 2008 crisis, largest loss of jobs has been recorded in the dramatically declining construction sector.

Table 1: Employment in construction, 2008-2013.

<table>
<thead>
<tr>
<th>Country</th>
<th>Change in employment, 2008–100</th>
<th>2008</th>
<th>2008-2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latvia</td>
<td>119</td>
<td>12</td>
<td>39</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>123</td>
<td>10</td>
<td>32</td>
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<td>Lithuania</td>
<td>121</td>
<td>11</td>
<td>42</td>
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<tr>
<td>Romania</td>
<td>170</td>
<td>11</td>
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<tr>
<td>Estonia</td>
<td>131</td>
<td>12</td>
<td>63</td>
</tr>
<tr>
<td>Slovakia</td>
<td>139</td>
<td>11</td>
<td>24</td>
</tr>
<tr>
<td>Spain</td>
<td>60</td>
<td>12</td>
<td>43</td>
</tr>
<tr>
<td>Ireland</td>
<td>143</td>
<td>11</td>
<td>60</td>
</tr>
<tr>
<td>Slovenia</td>
<td>139</td>
<td>7</td>
<td>15</td>
</tr>
<tr>
<td>Sweden</td>
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<td></td>
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<td>75</td>
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<tr>
<td>Belgium</td>
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<td>7</td>
<td></td>
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<td>France</td>
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<tr>
<td>Germany</td>
<td>88</td>
<td>7</td>
<td></td>
</tr>
</tbody>
</table>

(1) In countries where both the total number of jobs and jobs in construction declined between 2008 and 2013.
Source: Eurostat (ilfsa_egana; ilfsa_egan2), own calculations.

Adopted from: Myant and Piasna 2014, p. 11
It is said that for a plane to go down at least three malfunctioning have to happen simultaneously. It seems that similar could be said for the job losses in the construction sector. From Table 1 we can see that the largest loss of jobs was in the countries where the sector significantly increased prior to the crisis, experiencing the pre-crisis construction boom (thanks to the easy access to financial resources). When easy financing stopped, employment in construction fell and unemployment rose. “More than 40% of the job destruction in Spain from 2008 was in the construction sector and it could be argued that Spain was faced with a problem of economic structure that was exposed by the end of the easy credit that had financed the building boom, rather than with a labour market problem.” (Horwitz and Myant, 2015, p. 13). In countries where the increase of construction sector was smaller prior to the crises and was not primarily financed by external debt, the unemployment effect of construction decline on unemployment increase was smaller. We have also seen that large numbers of employees on temporary contracts, which could be easily fired, contributed to the increase in unemployment in some European countries. This may be a third malfunctioning in the construction sector (in Spain, in particular). If employees hired during the construction boom were on temporary contracts it was most likely that they were the first to be laid off when the crisis hit.

In addition to differential employment decreases resulting from the contraction of construction sector, analysts also point at a significant role played by differential changes in public sector employment following the crises, related to governments’ reaction to the crises. This is illustrated in Table 2.

Table 2: Change in employment (in ‘000s), 15-64 years old, 2008-2013.

<table>
<thead>
<tr>
<th></th>
<th>Total employment</th>
<th>Construction</th>
<th>Education, health, public administration</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU 28</td>
<td>-6330.2</td>
<td>-3662.2</td>
<td>1552.2</td>
</tr>
<tr>
<td>Euro area 17</td>
<td>-5133.2</td>
<td>-2616.6</td>
<td>821.9</td>
</tr>
<tr>
<td>Germany</td>
<td>1635.5</td>
<td>173.6</td>
<td>846.6</td>
</tr>
<tr>
<td>Ireland</td>
<td>-226.8</td>
<td>-135.4</td>
<td>16</td>
</tr>
<tr>
<td>Italy</td>
<td>-1025.3</td>
<td>-398.8</td>
<td>-143.9</td>
</tr>
<tr>
<td>Latvia</td>
<td>-142.3</td>
<td>-56.2</td>
<td>-12.3</td>
</tr>
<tr>
<td>Spain</td>
<td>-3314.9</td>
<td>-1427.6</td>
<td>52.5</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>127.4</td>
<td>-4845</td>
<td>468.3</td>
</tr>
</tbody>
</table>

Source: Eurostat (lfsa_egan2).

Adopted from: Myant and Piasna 2014, p. 12
The crisis itself had a far less direct impact on public sector employment than on employment in the construction sector. However, subsequent austerity measures, involving government-spending cuts, affected EU countries differently.

2.5 Concentration of employment in small and medium size enterprises (SME)

Next factor resulting in disproportional increase in unemployment in the Europe periphery countries is their higher than average share of employment in small and medium size enterprises (SME).


From the Graph 12 we see that SMEs employ the majority of the labour force in Europe. However, while in the UK and Germany, for example, this share is slightly above 50% and 60% respectively, the average employment share of SMEs in Southern European countries is above 75%, and is especially high in Greece – more than 85%. The share of employment in SMEs relates to increases in unemployment rates following the 2008 crises via the financial crisis.
reducing SMEs sources of financing, particularly in the crisis worst hit countries, which also have the highest share of employment in SMEs.

We cannot go into details of SMEs financing problems in this paper. Nevertheless, we shortly address it so that we can assess whether Investment Plan for Europe agenda can help reduce unemployment in part caused by SMEs difficulties to get loans in order to continue with or increase their economic activities and keep employees on board and/or hire new employees.

In short, the major challenge in financing SMEs is that they rely on bank loans for their financing much more than the large companies. In the period before the financial crisis, SMEs have actually had easy access to bank loans. However, after the financial crisis intensified in 2008, banks tighten credit conditions and SMEs faced the lack of money for both servicing their debts and investment. “...While having the greatest need for loans, it seems that SMEs in the countries with the fiercest recession and highest unemployment struggle the most in their access to bank credit, which is attributable to weaker profitability and lower capital positions” (Kaya 2014, p. 6). Not only it has become more difficult for SMEs to obtain loans, but also the borrowing costs for SMEs increased after the crisis much more than for the larger companies. Tightening of the criteria for the bank loans as well as the increase in borrowing costs for SMEs has been particularly prominent in southern Europe countries, where quick and easy access to financing is the most needed (Kaya 2014; Öztürk and Mrkaic 2014).

2.6 Skill composition of labour

Breakdowns of EU labour force show that the groups of low-skilled, temporary and young workers were most sensitive to the recession in euro area countries, following the 2008 crisis. Accordingly, a low skilled young person employed on temporary contract was most likely to lose his/her job in the recession. We have already discussed the impact of labour duality on unemployment increase in southern Europe countries. The impact of the crisis on youth unemployment will be addressed in one of the next sections of the paper. Here we just briefly report the data on sensitivity of worker groups to the crisis according to their level of education. (European Central Bank 2012)
Looking at the employment levels for Europe, data show that most of the jobs lost between 2008 and 2011 were occupied by low-skilled workers, joined by medium skilled workers in countries the most severely hit by the crisis and in the crisis peak in 2009. At the same time high-skilled employment continued to grow although at a slower pace. “Firms tend to retain high-skilled personnel since they have specific knowledge and skills and are less easily replaced, while low skilled people can be exchanged more easily.” (European Central Bank 2012, p. 22) Looking at the unemployment rates, low skilled workers unemployment rates increased more than for the rest of the labour force, with the exception of Greece, were unemployment rates for low skilled and medium skilled workers increased equally.

**2.7 Labour market institutions**

We have seen so far that unprecedented unemployment levels in the Europe's periphery countries could to a great extent “be understood through the prism of cyclical adjustment and as a reflection of the deleveraging needs in many sectors” (IMF 2014, Chapter 5, p. 37).
However, there are also accounts of the problem of high unemployment levels and increase in unemployment rates following the financial crisis in 2008 that take a longer, more structural view of labour market performance in European countries. These accounts claim “that recent labour market outcomes were also significantly influenced by structural policies undertaken in the past 20 years and the way these policies interacted with institutions and longer-term or structural shocks” (IMF 2014, Chapter 5, p. 37).

Discussion of the impact of labour market institutions on unemployment will be rather sketchy in this paper for two reasons. First, it does not feed into the assessment of the extent to which the Investment Plan for Europe would help decrease unemployment, since this plan does not involve labour market institutions reform directly. During the implementation of the Plan, however, this can be taken into consideration in the process of evaluation of project application, as a context in which a project would take place. Investment Plan may also rely on labour market reform as a support for its implementation. Secondly, only the impact of the pre-crisis institutions and their interaction with the crisis shock is relevant for the unemployment outcomes addressed in this paper. The effect of the labour market institutions reforms introduced during the crisis, is ambiguous. In the first place, they take place in the adverse environment of economic distress and their scope and effect is constrained by other policies, governments have introduced, to cope with the recession. Secondly, it takes time to observe the long-term effect of reformed labour market institutions.

The labour market institutions analysed in literature encompass:

1. Employment protection legislation (EPL) and related labour market dualism refereeing to differential protection of permanent and temporary labour contracts;
2. Unemployment benefits (UB) duration and levels;
3. Wage setting (wage bargaining) institutions (including minimal wage regulation);
4. Labour cost (in particular the share of social security taxes);
5. Active labour market policies (ALM), including training programs, job search assistance and fiscal incentives for employers to keep employees or hire unemployed workers.
Particular arrangements of these institutions in each country could lead to more or less “flexible labour markets” (or more or less “labour rigidity”). Flexibility (or rigidity) here refers to how easy labour markets can adjust to business cycle and unpredicted shocks in economy. Less strict EPL, low levels of UB, decentralized wage setting, low social security taxes and more ALM - implies more labour market flexibility, and the other way round. Most international economic institutions advocate for more labour flexibility. A theory underlining this position is that strict EPL renders firing and hiring of workers more difficult to employers and thus prevents efficient allocation of labour in the economy. Furthermore, high levels of UB increase the wage for which unemployed persons would return to work and thus increase unemployment levels and duration of unemployment. Centralised wage setting procedures prevent wage adjustment to labour productivity and may lead to higher unemployment levels, because if employers cannot reduce wages in a recession, they will turn to lying off the workers. High social security taxes increase the cost of labour for employers and may hinder additional employment. Finally, intensive ALMs help matching vacancies with available labour supply and thus shorten duration of unemployment (IMF 2014, Chapter 5).

Based on the institutional set up of their labour markets, Esping-Andersen classified countries into four broad models:

• “Anglo-Saxon countries, featuring limited government intervention, weak unions, decentralized bargaining allowing for substantial wage dispersion, low labour taxes, and employment-linked social benefits and active labour market (ALM) policies.

• Continental European countries, featuring strong unions and centralized bargaining, high labour taxes, generous UI, and in some cases, strong EPL.

• Mediterranean countries, relying heavily on stringent EPL and centralized bargaining, but offering low UI and limited ALM policies.

• Scandinavian countries, relying more on UI rather than EPL to address unemployment risk, and also featuring high labour taxes, strong unions, and compressed wage structures.” (Esping-Andersen 1990. In: IMF 2014,Chapter 5, p. 41)

We can see that, according to this taxonomy, in the pre-crisis period only Anglo-Saxon countries (in Europe it is primarily the UK) fit the profile of fully flexible labour market. Mediterranean countries (Southern European countries) do not differ that much from the continental Europe
group and Scandinavian countries. However, there are some differences worth mentioning. One of the important differences in Mediterranean countries is not so much the strictest EPL, but the way in which these countries found a way around it, through proliferation of employment on temporary contracts with less strict protection. Most of these jobs were subsequently lost following the crisis. Spending on ALM, on the other hand, seems to be lower in some Mediterranean countries than in the EU core countries, and, following the crisis, it further decreased (because of a conflicting need to cut government spending simultaneously). Wage bargaining was centralized, prior to the crisis, as in the most continental Europe and Scandinavian countries. However, there has been a consensus among the parties (including trade unions) in some of the Europe's core countries (for example, Germany) that wages could be reduced in harsh times in order to maintain current level of employment. It seems that, on the other hand, the well-protected insiders (employees on permanent contracts), in Southern European countries, objected to wage adjustments which might have put off layoffs in the period of economic growth slowdown.

As for the other institutions, they do not seem to be much different in Europe periphery from the continental Europe and Scandinavian countries. Minimum to median wage ratio and unemployment benefit coverage was lower than in the continental Europe and Scandinavian countries. After the crisis, however, while about half of the European area countries reduced social security contributions related to employment, some of the Europe periphery countries, including Greece, actually raised social security contributions, trying to reduce their budgets deficit. Unemployment benefit levels have been similar in the crisis worst hit countries to that in the rest of Europe after increasing in 2000s (and that has not happened in Greece due to the pressure to cut government spending). (IMF 2014, Chapter 5).

Looking at the interaction between labour market institutions and the output shock related to the 2008 crisis, advocates of labour market flexibility point that countries which achieved high levels of flexibility as early as 1980s or mid 1990s (such as Netherlands and the UK), as well as the countries which prior to the crisis undertook profound labour market reforms reducing labour market rigidity (such as Germany), fared much better in terms of the crises economic and social cost. Analysts also emphasize that labour market reforms in other EU countries were either
uneven or inconsistent or came too late to prevent adverse crisis impact (IMF 2014, Chapter 5; Aleksynska and Schindler 2011).

3. IMPLICATIONS FOR YOUTH UNEMPLOYMENT

Analyses show that young population in Europe is more sensitive to factors affecting unemployment than adult population is. This seems to be particularly prominent in countries which were most severely hit by the crisis. In the Graph 6 the unemployment rates for young NEET\(^3\) (between 15 and 24 years of age), for selected countries are presented.

Graph 14: *Share of Youth Unemployment.*

![Graph 14: Share of Youth Unemployment.](image)

Source: Eurostat data

Different trends for countries, that fared better economically in general, and the hardest hit euro area countries is obvious. In the former, youth unemployment rates increased only marginally (Austria, Netherlands) or even fell (Germany), whereas the latter experienced large increases in youth NEET unemployment rates. While the global crisis plays a significant role in the hardest hit countries, in some of them (for example, Ireland and Cyprus), unemployment rates largely increased after the crisis from relatively low pre-crisis levels, whereas in others, the youth

\[^3\] \text{NEET rates refer to young people not in employment and not in education and training. If rates are measured as total youth unemployment relative to active population, percents are even higher - levels ranging from 25 percent in Ireland to 43 percent in Spain on average during 2007–13(Benerji, December 2014).}
unemployment problem predates the crisis. It seems that, in these cases, the crisis exacerbated an already existing problem. Thus, Banereji states that any account of youth unemployment in Europe would need to address not only the flow but as well the stock of unemployment problem.

On the “flow” side of the problem authors point at the following reasons for large increase in the youth unemployment in the hardest hit EU countries. It is well documented that unemployment rates rise with a drop in economic activity, which holds as much for the young as for the general population. However, according to the IMF staff’s estimates, “youth unemployment rates are, on average, almost three times as sensitive to output growth as adult unemployment rates. This relationship holds true in every country, notwithstanding wide variations in employment dynamics across countries” (Benerji 2014, p.11). Subsequently, countries with the largest decline in economic activity since the crisis also experience the biggest increases in youth unemployment rates. Based on the IMF staff estimation, Banereji claims that “in vulnerable euro area countries, changes in output explain about 70 percent of the increase in youth unemployment during the crisis.” Expressed as effect of a percent increase in GDP “one additional percentage point of annual GDP growth is associated with a decline in the youth unemployment rate by an estimated 1 percentage point in Greece and Portugal, and by almost 2 percentage points in Spain.” (Benerji 2014, p. 11)

High sensitivity of youth unemployment to fluctuations in economic activity is associated with the concentration of youth unemployment in cyclically sensitive industries, in small and medium size enterprises (SMEs), as well as in temporary and part time employment (Benerji, December 2014). In countries where youth unemployment increased the most (Cyprus, Ireland, Spain, Portugal, Greece, Italy), between 65% and 75% of youth employment, before the crisis, was concentrated in cyclically sensitive industries such as construction, manufacturing, wholesale and retail trade, and hotels and restaurants. These sectors have been hit hard by the crisis, in particular the construction sector, following the collapse of the housing boom, resulting in large layoffs of employed.

Authors also highlighted that youth tend to be employed on temporary contracts more frequently than adults (on average 37% and 9%, respectively, of employed individuals in 2013, virtually unchanged since 2007). (OECD 2006. In: Benerji 2014; Scarpetta, Sonnet, and Manfredi 2010)
Most relevant in the context of higher youth unemployment since the crisis are temporary contracts, which are not associated with education and training. Temporary contracts are associated with labour market duality through which permanent jobs enjoy high institutional protection of employees, whereas employee on temporary contract are unprotected and first to be laid off in times of economic decline. Part-time employment is also more frequent among youth than among adults, and it has increased since the crisis.

Whereas labour market literature suggests that sharp increases in the youth unemployment are largely a result of a drop and a subsequent lack of growth of GDP, for the explanation of high levels of youth unemployment (so called the “stock” problem) on average and of the countries differences in that respect, authors turn to the countries labour market characteristics, in particular labour market institutional set up.
For a summary of the impact of labour market institutions on the level of EU youth unemployment we rely on IMF staff estimates obtained by a multivariate model⁴. This analysis finds that following institutions have stronger effects on youth than on adult unemployment levels:

1. Higher labour costs, measured by tax wedges comes with higher youth unemployment rates by 0.3–1.3 percentage points for a percent increase in tax wedges (compared to around 0.5 percentage points increase in adult unemployment rates). Higher labour costs measured by “minimum wages relative to median wages comes with higher youth unemployment by 0.4–1.2 percentage points (while the effect on adult unemployment is insignificant)” (Benerji 2014, p. 15).

2. Higher gross replacement rates of unemployment benefits (used as a measure of opportunity cost of employment) increase youth unemployment by about 0.5 percentage points for a 1 percentage point increase in unemployment benefits level (compared to adult unemployment rates increase by 0.1–0.2 percentage points).

3. The strongest impact on youth unemployment levels is estimated for the duality of labour market. Less duality of labour markets measured by higher employment protection legislation rating for temporary contracts is associated with lower youth unemployment rates by 2.5–5 percentage points for one-unit increase in the protection for temporary contracts (compared to 1.5–2 percentage points decrease of adult unemployment). A higher share of youth on temporary contracts relative to all employed youth is associated with higher youth unemployment by 0.3–0.4 percentage points (whereas higher shares of adult workers in temporary contracts showed no significant correlation with general adult population unemployment rates).

4. Higher spending in ALMPs, especially training, measured by an additional 1000 euro per unemployed increase in ALMP spending is associated with lower youth unemployment by around 0.3 percentage points (compared to around 0.1 percentage point for adult population).

5. Finally, the analysis shows that more vocational training “measured by the share of temporary workers in probationary periods or vocational training...corresponds to lower youth unemployment by around 0.3 percentage points” (Benerji 2014, p. 20). This institution is not relevant for adult population and its impact to youth and adult cannot be compared. The

⁴“The estimates...are based on a specification that includes several labor market features at a time (“multivariate model”) and assumes that the impact of labor market factors, if any, is common across all countries. It allows the impact of the business cycle (output gap) to vary across countries.” (Benerji 2014, p. 26)
implications of these findings for the policy making will be discussed in the chapter on policies to reduce unemployment.

4. IMPLICATIONS FOR THE DURATION OF UNEMPLOYMENT

“...Those individuals who have been in unemployment for long periods of time are more likely to become discouraged and leave the labour market altogether. As a result, skills erode, productive capacity declines and their employability deteriorates – making it increasingly difficult to find a new job when the labour market begins to recover.” (ILO 2015, p. 9)

Even prior to the global financial crisis (and subsequent economic recession), based on the trend in Europe unemployment rates until 2004, Oliver Blanchard (Blanchard 2004) identified as one of the four important characteristics of European unemployment that its increase “reflects an increase in duration rather than an increase in flows in and out of employment”. This diagnosis seems to be confirmed by the developments after the crisis, when after the unemployment rates somewhat decreased from its peak in April 2013, long-term unemployment (generally defined as being out of work for over 12 months) has persisted. More than half of the European unemployed in the first quarter of 2015 have not worked for more than a year. Over 15% of them have been unemployed for more than four years (see Graph 15). The problem is most severe in southern Europe and Ireland where the long-term unemployment rates increased by more than 25 percentage points between the third quarters of 2007 and 2014 (see Graph 16).

Long-term unemployment is particularly harming primarily for the persons experiencing it, but also for the economy as a whole, since according to various reports it tends to be self-sustaining. The longer a person is unemployed, the less likely he/she is to find the job. Therefore, it threatens to divide the labour force between the “insiders” who hold for their jobs and long-term unemployed who increasingly become unemployable.
Graph 15: *Unemployment rate by duration (%).*

Adopted from: The Economist, 2 August 2015

Graph 16: *Long-term unemployment rates in Q3 2007 and Q3 2014 (as share of total unemployment).*

Notes: Long-term unemployment rate refers to the number of unemployed persons out of work for 12 months or more as a share of the total number of unemployed.

Source: ILO Research Department based on Eurostat.

Adopted from: ILO 2015, p. 8
Some of the factors described in the previous sections as contributing to both, Europe's unemployment and differences in unemployment rates among EU countries, feed into this picture. Thus, if policy makers in Europe and particular countries intend to confront the problem of long-term unemployment they have to consider those factors.

The analyses show that the crisis initially resulted in an increase in short term unemployment, due to the newly unemployed that had lost their job between 2008 and 2009. However, as the crises continued and the unemployed were not able to find new jobs, long-term unemployment started to increase at the beginning of 2009. Since, as we have seen, in the Europe periphery the crisis extended beyond 2011, these countries experienced particularly high shares of long-term unemployed.

Formulated in the simple way, unemployed may not find new jobs because there are not new jobs created (in the situation of low growth and subdued investment), or the vacancies and new jobs created do not match available skills of unemployed, or/and unemployed are not willing to work for the low wages associated with the jobs on offer.

Helping growth and job creation - resolving the debt crisis in worst hit countries, relaxing fiscal constraints, increase spending and investment, facilitating SMEs financing would increase demand for labour. However, the demand most probably will not be in the sectors where the most jobs were lost (such as construction and manufacturing), and not for the low skill labour, which was mostly affected by the post crises layoffs. This would exacerbate the problem of skill mismatch in Europe. Thus, analysts claim that in addition to enhancing labour market mobility in search of jobs across Europe, Europe and some countries in particular need to address the issue of skill composition of its labour force. (Benerji 2014; European Central Bank 2012)

The supply side policy defenders, on the other way, see the long-term unemployment as being created by the rigid labour market institutions, hindering job turnover, and, primarily, generous and long lasting unemployment benefits, rising the wage for which unemployed would be willing to return to work. Thus, many policies aiming at increasing labour market flexibility were proposed and imposed by IMF and European governing bodies to some European courtiers prior and during the crisis.
Finally, both demand and supply side policy defenders advocate for more ALMPs, which as we have already seen were reduced during the crisis due to the attempts to cut government spending under the pressure for fiscal consolidation.

5. POLICIES TO ADDRESS HIGH UNEMPLOYMENT

"Without higher aggregate demand, we risk higher structural unemployment, and governments that introduce structural reforms could end up running just to stand still. But without determined structural reforms, aggregate demand measures will quickly run out of steam and may ultimately become less effective. The way back to higher employment, in other words, is a policy mix that combines monetary, fiscal and structural measures at the union level and at the national level."

(Draghi 2014)

Reducing the level of unemployment is an aim declared by both economic analysts and policymakers across the political spectrum. Everybody agrees that a strategy to create jobs is urgently required. However, the means they have been advocated for achieving this aim vary from focusing on restoring demand for labour by higher spending and investment (ETUC 2013) to emphasizing the need for larger flexibility of labour markets for achieving greater employment creation (Business Europe 2014).

What conclusions could be drawn on the discussion of factors affecting EU unemployment rates in respect to what policies, if any, would be effective in order to reduce the unemployment?

Firstly, we have showed that more than half of total unemployment increase in EU following the 2008 crises concentrated in the southern European countries and that the policies to reduce unemployment in Europe should directly or indirectly target the causes of unemployment in these countries. Secondly, we have seen that a large share of sharp increase of unemployment in these countries related to a decline of output growth associated with a large decline in investment levels. Drop in investment, on its side, related to high indebtedness of both private and public sector in these countries and a need to repair their balance sheets, after a surge of capital inflow and easy borrowing conditions enjoyed prior to the crisis suddenly stopped.

Significant cyclical component of current EU unemployment justifies undertaking demand side policies. A textbook demand side policies recommended in situations of deep recession and low
inflation levels, such is the case in post-crisis Europe, are expansionary monetary and fiscal policies.

Expansionary monetary policy involves reduction of interest rates. However, interest rates in euro area since the crisis have been extremely low and yet it has not resulted in increase in spending and investment, among other reasons, because the banks tighten their borrowing conditions after the financial crisis and are still reluctant to lend. We have seen that this has produced tremendous difficulties for the SMEs financing, especially in the crisis hardest hit countries of southern Europe. Thus, policies should address this problem and find way to diversify and facilitate financing of SMEs.

Expansionary fiscal policies include reducing tax burden and/or increasing government spending. The expectation is that lower taxes would create higher aggregate demand (AD) by increasing disposable incomes and enhance consumption. An increase in AD would result in more production and an increased demand for workers which would than reduce unemployment. Expansionary fiscal policies, however, require more government borrowing, which may not be possible for already highly indebted countries such are southern European countries. Not only is further borrowing impossible for these countries, but they are under the pressure to reduce already existent debts in order to comply with the European monetary union rule of maximum budget deficit allowed. Thus, instead of expansionary fiscal policy, the European financial bodies stand until 2013 was a policy of fiscal austerity, which seems to have hindered the growth and has extended duration of recession in the most indebted countries.

Faced with largely inadequate monetary and fiscal policies results, exponents of powerful international (financial and political) organizations turned to supply side policies to address unemployment, advocating for comprehensive reforms of labour market institutions.

Whereas there seems to be a consensus across the political spectrum about the demand side policies, primarily about the need to increase the levels of (preferably private) investment and to facilitate SMEs access to financing, there has been considerable disagreement about effectiveness of some of the supply side policies proposed to be introduced. Supply side policies are supposed to address structural part of recorded unemployment, for the most part accounted for by the skill mismatch problem and labour market rigidity. While most analysts agree that the
policies to tackle the skill mismatch, polices to increase labour market flexibility seem to be a matter of debate.

In his speech from August 2014, ECB president, Mario Draghi, for example, advocates the policies that would “allow workers to redeploy quickly to new job opportunities and hence lower unemployment duration. Such policies include enabling firm-level agreements that allow wages to better reflect local labour market conditions and productivity developments; allowing for greater wage differentiation across workers and between sectors” (Draghi, 2014). Theory behind advocating for more flexible labour market equates flexibility with falling pay levels if demand for labour appears inadequate. Lower wages should then lead to higher employment as employers can profitably take on more employees. If we apply this argument to concrete situation of most of the jobs lost in the contracting construction sector it would imply “that unemployed construction workers could find alternative employment, either at lower pay in the construction sector or in newly-created jobs in other sectors. Similarly, the decline in other sectors would be compensated by growth elsewhere, if pay were low enough.” (Piasna and Myant, 2014, p. 9). Myant and Piasna, from the European Trade Union Institute, demonstrate that it has not been the case. They conclude that policies, which are more promising, involve economic “transformation towards activities requiring highly qualified labour, which is also likely to be highly paid, rather than towards reducing pay levels in the hope that more employment opportunities will then appear.” (Myant and Piasna 2014, p. 6).

The second point of disagreement on the supply side policies relates to how to address the problem of labour market dualities, which, as we have seen, accounts for a part of overall job losses during the recession. Most international organizations (IMF, ECB, EC) and some governments (such as Spanish), propose to reduce labour duality by worsening the conditions of those workers employed on permanent contracts.5 This stems from a theoretically relatively well-grounded claim that reduction in EPL, resulting in easy firing and hiring, accompanied by a decrease in unemployment befits duration and levels, would decrease unemployment levels. However, in concrete terms, if employment protection is relaxed and unemployment benefits reduced, during economic recession, and in the absence of job offers, it can only result in increase in unemployment, at given level of wages, and impoverishment of part of the population. Thus,

5 Pursued to its extreme, this would imply all the employees being on temporary, low protected contracts.
alternative way of reducing labour duality is visible in lifting the protection levels for the temporary employees, so that it approximates the levels of protection enjoyed by the employees on permanent contracts. (Horwitz and Myant, 2015)

There seems to be a consensus among the labour market policies analysts that an increase in labour demand, following economic recovery, would not be for the low skilled labour (although we have seen that the majority of unemployed following the crises were low skilled), and that demand most likely would not increase in the sectors where the most of the jobs were lost (such as construction and manufacturing). Thus, it is concluded that Europe and some countries in particular need to address the issue of skill composition of its labour force. The labour force should be equipped by the skills necessary for high-productivity sectors (European Central Bank 2012; Myant and Piasna 2014; Draghi 2014).

Policies should therefore focus on further reforms of education systems, in direction of larger shares of population attaining upper secondary or tertiary education. But there is also an important role for active labour market policies, such as lifelong learning, off the job and on the job trainings. In that respect, eradicating labour market duality would “help reduce inefficient worker turnover and increase incentives for employers and employees to invest in developing job-specific skills.” (Draghi, 2014)

6. INVESTMENT PLAN FOR EUROPE

6.1 Description of the plan

Taking over the presidency of the European Commission, Jean-Claude Juncker declared that his “first priority as Commission President will be to strengthen Europe’s competitiveness and to stimulate investment for the purpose of job creation.” (Juncker July 2014, p. 4). He outlined the importance of an investment plan for Europe on July 15th 2014, saying that it is urgently needed in order to boost growth and investment in the EU28. European Commission officially announced the Plan on November 26th, 2014. Three main policy objectives were declared:
1. To “reverse downward investment trends and help boost job creation and economic recovery” (European Commission 2014, p. 5);
2. To lay ground for increasing of competitiveness and meeting the long-term needs of the economy;
3. To focus on strengthening knowledge, human capital, productive capacity and physical infrastructure particularly focusing on interconnections which are vital to the European Single Market.

These objectives shall be achieved through three groups of activities.
1. The first group of activities focuses on raising capital.

The goal is to mobilize at least €315 billion of additional private and public investment in the following three years (between 2015 and 2017). European Commission provides the initial €16 billion from the EU budget and the additional €5 billion from the reserves of European Investment Bank (EIB). This €21 billion reserve will allow EIB to make loans of €63 billion, in order to finance the riskier components of investment projects, leaving the remaining €252 billion to be put forth by the private sector. This is in line with the goal to raise capital “without weighing on national public finances or creating new debt”. (European Commission 2014, p. 5)

The public money should provide bigger risk-bearing capacity in order to attract private investment “which would not happen otherwise” (European Commission 2014, p. 6), making the best use of European Union public resources Thanks to the initial risk protection, 1 euro of protection will suppose to create 15 euro of investment, impossible to happen otherwise. The Plan estimates that a multiplier effect of 1:15 could be attained in investment in real economy. The multiplied impact of the Investment Plan is expected if more stakeholders participate, according to their specific roles. The European Commission (EC) and the European Investment Bank (EIB) invited other European Institutions, all Member States and their regional authorities, National Promotional Bank (NPBs) and private investors to join the Plan. By acting together and in a coordinated way, they believe that they will be able to gain even more than €315 billion. Some countries have recently announced amounts they are willing to contribute to the investment fund.

A new financial entity at EU level i.e. the European Fund for Strategic Investments (EFSI), which was established as result of strategic partnership between the EC and the EIB, will hold the
funds. The EFSI is a “dedicated trust-fund” (European Commission 2014, p. 6) created within the EIB-Group and its main role is to “ensure enhanced risk-bearing capacity and mobilise extra investment, essentially from private sources, but also public sources, in specific sectors and areas” (European Commission 2014, p. 8). Among others, its task is to identify needs and to single out projects “delivering higher societal and economic value” (European Commission 2014, p. 6). At national level, the European Structural and Investment Funds are supposed to be used more effectively.

2. The second group of activities is supposed to ensure that the available funds reach the real economy (actually producing goods and services).

This will be achieved by improving access to information on investment projects in Europe of private investors and public authorities and through a particular project selection mechanism. Most of stakeholders are not concerned with a lack of finance but rather with absence of viable projects as well as with information needed to assess the risks involved. According to the European Commission, “private investors are often unaware of the potential of these projects”. Since they have lack of information to evaluate risk properly, they are reluctant to invest, especially in long-term projects in infrastructure. Through the second group of the Plan related activities, Member States as well as their NPBs will contribute to the creation of a pipeline of investable projects with European significance at EU level. However, not every project in the created pipeline “should or will be financed under the Plan or through the new Fund, but it will allow public and private investors to access relevant and transparent information” (European Commission 2014, p. 12).

The projects financed under the Investment Plan should be such as to “promote innovative, sustainable and job-rich growth” (European Commission July 2014, p. 9). They should concentrate on “infrastructure, notably broadband and energy networks as well as transport infrastructure in industrial centres; education, research and innovation; and renewable energy. A significant amount should be channelled towards projects that can help get the younger generation back to work in decent jobs” (Juncker July 2014, p. 4). In addition, SMEs and mid-cap companies will be also supported by the Fund through European Investment Fund (EIF). They will be able to obtain higher sums of direct equity and in that way to overcome capital shortages and

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6 A tentative list of projects developed by the Member States is already compiled by the Fund Task Force.
have additional guarantees. Junker says that SMEs are job creators and backbone of European economy “creating more than 85% of new jobs in Europe” and that they need to be free from “burdensome regulation”. (Juncker July 2014, p. 5)

The projects supported by the Plan must generate growth and add value to European social market economy, be viable and start within the next three years. In addition, they “should address the unmet needs” (European Commission 2014, p. 7) and be such as to leverage other funding. These criteria will be the basis for the selection of projects and they will be without thematic or geographic pre-allocations.

Investment advisory “Hub” will have a task to give technical assistance to project promoters, investors and public managing authorities related to project preparation. This involves assistance with making the most out of innovative financial instruments at national and European level as well as of “public-private” partnership schemes. (European Commission 2014)

3. The third group of activities aims to improve the investment environment in Europe by removing barriers to investment and by creating better framework conditions for investment that is going to reinforce the Single Market. Upgrading European single market primarily relates to a Capital Markets Union, with the eventual aim of reducing fragmentation of EU financial market regulation, as well as diversifying finance for small and medium-sized enterprises (SMEs). However, it also includes the European Energy Union, transport infrastructure and systems, the Digital Single Market, service and product markets (particularly through deregulation), and research and innovation.

The Parliament and the Council put in force legislative measures needed in order to simplify regulation and reduce burdens, especially for SMEs, both on the EU and national level and in that way to facilitate long-term investments. Both the European institutions and the Member States are jointly responsible for better regulation, which “should remove obstacles to growth, allow new opportunities to flourish, minimize costs and guarantee social and environmental sustainability”. Since most of SMEs still have limited access to finance and free movement of capital in the EU, the goal is to help them obtain credit from risk-averse banks by creating stable,
transparent and safe financial sector. Consequently, they will be able to invest and create new jobs.

Through these activities the European Commission estimates that the Investment Plan could “add €330 to €410 billion to the EU’s GDP and create 1 to 1.3 million” additional jobs between 2015 and 2017 (European Investment Bank 2015, p. 4). In addition, the Commission believes the Plan will change public policy and financing tools reinforcing investment in Europe.

6.2 Expected impact of the Investment Plan on reduction of unemployment

The impact of the newly released investment plan on high European unemployment rates cannot be assessed empirically, since it has been just introduced with no effect to be captured in empirical data. We can however compare declared intentions of the Plan with results of the preceding discussion on factors increasing unemployment. To the extent to which the Plan targets unemployment sources, we can say that it is reasonable to assume it would at least dent the unemployment.

To start with, we will assume that the Plan would attain its objectives as declared. In the announcement of the plan it is assessed that it would mobilize around €315 billion and produce between 1 and 1.3 million of new jobs. It is related, but it is not the same as saying that it would reduce unemployment. A short and medium term reduction of unemployment would stem from the fund allocation so that it addresses the sources of current unemployment in EU as described in the previous parts of this paper.

The first issue to tackle here is whether this unemployment is cyclical or structural. Primarily, the Investment Plan is designed to affect the demand for labour and most probably cannot directly address structural causes of unemployment. Since we have seen that a large part of the post-crises unemployment in Europe is cyclical, and that a drop in investment is closely related to it, the aim to increase demand through investment seems to be well targeted.

However, we have also seen that drop in investment and aggregate demand has not affected EU countries equally, resulting in largely different unemployment rates changes following the crises.
Therefore, the second question to consider here is whether to allocate the funds disproportionately the worst hit countries. According to the original presentation of the Plan, this is not going to be the case. The selection of projects to be financed will be conducted under the criteria that do not include geographic pre-allocation. The extent of unemployment is not a criterion either. Thus, it may happen that the promised jobs will be created in countries and sectors where demand for labour already exists and no additional stimuli are needed for job creation. This may indeed increase growth and facilitate quicker recovery of EU economy as whole, but not in countries with the largest growth problem and without reducing unemployment where needed.

The Plan's success largely rests on mobilization of private investment. It is most likely that the allocation of the funds will follow the logic of strategic investment decisions, in a sense that the projects will be selected based on “their potential for innovation and growth-enhancing impacts, as well as the likelihood of private sector engagement” (ILO 2015, p. 18). However, the analyses show that the countries with highest increase in unemployment during the crisis are also the ones where the private sector is facing biggest financing difficulties. “…In some countries the combined effect of fiscal consolidation measures and tight credit conditions – characterizing the current approach to the crisis – has considerably reduced the resources available for private and public investment and the ability to leverage sources of financing such as the EIB, further contributing to the deterioration of macroeconomic and labour market performances”. (ILO 2015, pp. 14,15) Thus, it is likely that under the current allocation of funds, involvement of private investors from the most adverse crisis hit countries will be much weaker than from the rest of EU countries. “For instance, an analysis of the geographical destination of EIB funding reveals a high degree of concentration across EU Member States, with France, Germany, Italy and the United Kingdom receiving more than 45 per cent of all funding (figure 4). In that regard, it is important to note that in recent years the disproportionate rise in unemployment levels occurring in some countries has not been followed by a parallel increase in financing from the EIB. For instance, Greece currently receives only 2.3 per cent of total EIB funding going to EU Member States, while it hosts 5.1 per cent of EU unemployed (in 2007 these percentages were equal to 1.8 and 2.4 per cent, respectively). Similarly, Spain receives 16.6 per cent of total EIB funding within the EU, but it hosts 23.1 per cent of total unemployed in the EU (in 2007 the relation was reversed and these shares were equal to 17.3 and 10.8 per cent, respectively).” (ILO 2015, p. 14)
Thirdly, we have seen that beyond differences in GDP (and investment levels), EU countries experienced different unemployment rates due to several additional sources. By looking at the Plan criteria for selection of projects and declared investment targets, we can assess how well they match these sources of unemployment. If the criteria and targets match the unemployment sources, we can expect that, without directly targeting the worst hit countries, the investment under the plan may as well lead to a reduction in unemployment there indirectly. Three targets of the Investment Plan are prominent in this respect.

The first relates to determination expressed by the Plan to direct a part of the funds mobilized towards facilitating and diversifying financial sources for the European SMEs. SMEs are the largest employer in the EU member states, and the size of SMEs sector is larger than on average in some of the countries with highest unemployment rates. However, SMEs suffered from the lack of easily obtainable financing following the crisis, and these problems are larger for the countries that are hardest hit by the crisis. Raymond Torres, Director of ILO Research
Department said in a TV program that “...in high unemployment countries: Greece, Spain, Italy, and so on, there are many small enterprises that want to invest, and cannot invest because they do not have proper access to bank credit” (UNIfeed 2015). It seems that the Plan aims at removing the financial constrains SMEs have been facing.

The second Investment Plan target - investing in education, training, skill enhancing, matches the need for improving the skill composition of labour force. This may in the long-term lead to reduction of unemployment, since we have seen that the first to lose their jobs were low and medium skilled employees.

The third target – “get the younger generation back to work in decent jobs” (Juncker July 2014), matches the finding that youth unemployment comprises a large share of the unemployment in some of the EU countries. However, this is also a long-term impact, since the current stock of youth unemployment is mainly low skilled and will not easily and soon obtain skills necessary for good quality (high skill) jobs created under the Investment Plan.

To our knowledge, no presentation of the Plan has ever explicitly addressed the issue of contraction of construction sector (which as we showed caused significant amount of job losses in the Europe periphery). Indicators reported for the fourth quarter of 2014 and the first two months of 2015 suggest only small growth in investment in construction and no increase in construction output. It is, however, expected (in the economic outlook for Europe, spring 2015) that the Investment Plan “should eventually have a positive impact on construction investment, but...the impact will become more meaningful towards the end of the forecast horizon, as decisions about projects, implementation and disbursement will take time.” (European Commission 2015, p. 28)

We have compared the Investment Plan agenda with the factors affecting unemployment growth under the assumption that the Plan would fully accomplish its objectives as declared. However, some doubts related to whether, and under which conditions the Plan will actually reach its targets, have already been raised. On the one side, doubts have been expressed that the planned funds will be successfully mobilized. On the other side, there are concerns related to the actual numbers of jobs created during the Plan implementation. In order to go a step further towards
more exact “prediction” of the Plan's impact on employment growth in the rest of this part, we report results of the International Labour Organisation (ILO) simulation. (ILO 2015)

ILO conducted series of simulation of the Investment Plan impact on job creation, under different scenarios of fund allocation\(^7\). These scenarios measure estimated an increase of employment levels relative to a baseline level achieved by a GDP growth forecasted in the EU economic outlook, without any policy intervention (assuming that the Investment Plan has not taken place). Under this assumption, the estimated employment growth in EU, in the three-year period between 2015 and 2017, would be 0.6 percent. The first ILO simulated scenario then assumed that there has been an investment injection into EU economy amounting to €63 billion of EU public money (as in the case in which the Plan would not succeed to mobilize any private investors to join the Plan). Further assumption of this scenario is that the available money would be invested in infrastructure only and distributed among the countries proportionally to their GDP. Under this scenario, the increase in EU employment will be further 430,000 jobs created. The second ILO scenario assumed that “the plan succeeds in encouraging the private sector to invest to the full extent” (ILO 2015, p. 17). The allocation of €315 billion fund raised in that way, would be allocated as in the first scenario, but will also be distributed between the infrastructure related projects and SME financing (€240 billion and €75 billion, respectively). The estimated impact of that scenario would be a rise of 1.8 million jobs in addition to the baseline level.\(^8\) By the two described scenarios, ILO staff intended to emphasize the importance of the private sector investment under the Investment Plan.

The next two ILO scenarios point at the importance of decisions about the investment fund allocation taking into account the difference in unemployment levels recorded for different EU countries. The third scenario allocates one third of the €315 billion fund proportionally to the relative size of countries' economies (the levels of GDP), as in the previous scenarios, but the remaining two thirds are allocated based on the countries' unemployment levels. The estimated employment gain of this scenario is 2 million jobs more than the baseline level. The impact on

\(^7\) Estimations of employment impact of different scenarios were based on the ILO, Trends Econometric Models, October 2014.

\(^8\) “This impact reflects direct effects from spending, namely a direct increase in employment associated with the investment projects, as well as any indirect spillovers deriving from knock-on spending in the wider economy... A productivity-enhancing component is also included in the model and reflected in the employment gain presented here.” (ILO, 2015, p. 18)
employment under this scenario is bigger, but, what is more important, the share of the increase in employment for the countries in greatest need would be larger than in the previous allocation scenarios (which do not target labour market situation in the EU countries directly).

Graph 18: Employment outcomes under different Investment Plan allocations (millions of Euros).

Adopted from: ILO 2015, p. 19

The final ILO staff exercise simulate the effect of €15 billion (out of €315 Investment fund) being used for financing of active labour market policies (ALPMs), primarily training and job finding assistance, while the rest of the fund is allocated as in the scenario 3. They estimate that net employment gain of investment in ALPMs will be 126000 jobs in addition to 2 million estimated under the previous scenario. This would bring total employment gain of “job-friendly” allocation of the fund to over 2.1 million.
CONCLUSION

There has been a sharp increase in unemployment in Europe following the global financial crisis in 2008. Crisis related changes in unemployment rates have been remarkably different among European member states. Largest unemployment increases occurred in Spain, Greece, Ireland, Portugal, Cyprus and Italy.

Large part of unemployment changes in Europe since 2008 could be accounted for by the changes in economic decline following the crises. Countries with highest drop in GDP experienced largest unemployment increases, whereas countries with smaller GDP decreases fared much better in terms of unemployment rates. Major contributor to GDP decrease has been a drop in investment levels. The size of change in investment levels also differed among European countries. Unemployment rates decreased sharply in countries with largest drop in investment levels following the crisis, whereas increase of unemployment rates was also small or negligible in countries with small decreases in investment levels.

In view of the literature we have reviewed, we claimed that the countries, which experienced the worst growth and unemployment outcomes during the crisis, are the ones that had the most rapid debt increases prior to the global financial crisis. The debts were created in times of low borrowing costs and abundant global liquidity. When the crisis hit, and the money flow stopped, these countries faced tremendous difficulties to lower and service their debts.

We have also seen that some other factors contributed to excessive increases in unemployment rates in southern Europe countries, in addition to large decrees in GDP and investment. For example, we showed that, where the corporate sector deleveraging took place in countries with the large share of employment on temporary, low protected, labour contracts, in order to increase their profit shares, employers turned to laying off workers, thus increasing unemployment. The largest share of post-crisis unemployment increase came from contraction of construction sector after the financial crisis. The highest increase of unemployment rates occurred in countries that experienced pre-crisis construction boom, largely financed by loans, and with most of the pre-crisis employment growth in jobs on temporary contracts. Following the contraction of the construction sector, most of the temporary workers lost their jobs.
High unemployment in southern Europe countries has been further aggravated by unfavourable financial situation of SMEs—major employers in these countries. SMEs heavily rely on bank loans, which are, after the financial crisis, much harder to get and with much higher borrowing costs, than prior to the crisis. In terms of skill composition of unemployed, we showed that the least affected by the post-crisis surge in unemployment were high skills employees, whereas the first to lose their jobs were low skilled workers.

As bulk of the literature put a part of the blame for high employment sensitivity to the crisis shock on labour market institutions, we looked at the pre-crisis institutional particularities of the southern Europe countries that may have contributed to larger unemployment increases. We found that two features have been most prominent in that respect. The first is sharp labour market duality between well-protected permanent contract employment and much less protected employment on temporary contracts. This, accompanied with centralized wage setting procedures, prevented wage adjustments in the period of economic growth slowdown, and resulted in massive layoffs of workers on temporary contracts. The second distinctive institutional feature in these countries is low and decreasing spending on active labour market policies, which might have helped better matching of vacancies and labour supply and shorten duration of unemployment.

Accumulation of all these factors in the worst affected countries produced two major evils and most worrying outcomes in the labour markets in Europe—high levels of youth unemployment and long-term unemployment. A large share of young people have tremendous difficulties to access more permanent and well-paid jobs in these countries. This leads to discouragement, skill depreciation and brain drain. The labour force, and society as a whole, is divided to insiders—employees on secure permanent contracts and outsiders - employees moving from one temporary job to another, for a low pay, or unemployed for a long time and even dropping form the labour force completely at high social cost.

We discussed the polices to decrease unemployment in Europe in the last parts of this paper, and in that context, a possible impact of the Investment Plan for Europe, the most recent agenda for increase of economic growth in Europe, which also promises to create new jobs and boost employment. We have claimed that given the fact that more than half of total unemployment
increase in the EU, following the 2008 crises, is concentrated in the southern European countries, the policies to reduce unemployment in Europe should directly or indirectly target the causes of unemployment in these countries.

We have seen that there has been a broad agreement in the literature that the crux of policy effort should concentrate on lifting aggregate demand. The policies of fiscal austerity should give way to policies boosting economic growth, primarily by stimulating higher levels of investment into real economy. In order to mobilize private investments alongside public financing, policy makers should find way to diversify and facilitate financing of SMEs, which are the major employers in the southern Europe countries. There has also been a consensus that policies should focus on improving the skill composition of labour force in Europe, so that it matches demand for labour.

Not as much of consensus, however, exists across political spectrum on the policies aiming at enhancing labour market flexibility. These policies have been strongly advocated by the proponents of the largest international financial institutions. In fact, countries with high levels of labour flexibility prior to the crisis, as well as countries which prior to the crisis undertook profound labour market reforms reducing labour market rigidity, fared much better during the crises triggered recession. However, some authors question the effectiveness of more labour market flexibility being introduced in the countries where the crisis has already severely undermined growth and creation of jobs. In such a situation, they worry, relaxed employment protection and reduced levels of unemployment benefits, in the absence of job offers, can only result in further unemployment (at given level of wages) and impoverishment of part of the population.

Finally, we attempted to assess possible impact of the Investment Plan for Europe on reduction of unemployment by comparing declared intentions of the Plan with the results of the exploration of factors increasing unemployment. We have also taken into consideration the results of the ILO simulation of employment impact of the Plan, under various scenarios of investment fund allocation. It could be concluded that the Plan is on good track with its declared intentions to increase the level of investment and to direct it into real economy. Promising aspect of the Plan is that it intends to mobilize private sector investment and to divert part of the raised funds towards
improving the financial situation of SMEs. The declared intention to invest in education and training is also well targeted.

However, two major treats may undermine the Plan’s impact on unemployment. The first refers to whether the planned funds will be fully raised and private investors successfully mobilized. If that does not work well, the employment impact of the Plan would be very small. The other treat is that, given the allocation criteria, the funds will not rich the countries with highest unemployment rates. The promised jobs may be created, but maybe only in countries and sectors where demand for labour already exists and no additional stimuli are needed for job creation. The creators of the Plan than may well declare, in the end of the three-year-period that the Plan has achieved its objectives, since there has been an increase in growth and employment in the EU economy as whole, but, at the same time, not accomplishing much in stimulating growth in countries with the largest growth problem and reducing unemployment where is most needed.
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