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COMMUNICATION FROM THE COMMISSION

Key messages from the Employment in Europe 2007 Report

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1. INTRODUCTION AND KEY FINDINGS OF THE REPORT

This Communication presents the main findings of the Employment in Europe 2007 report. This is the 19th edition of the report, which has become one of the main tools of the European Commission in supporting Member States in the analysis, formulation and implementation of their employment policies.

Employment in Europe traditionally provides an overview of the employment situation in the EU, and focuses on a limited number of topics that are high on the EU's employment policy agenda. The overarching themes of this year's edition are a life-cycle approach to work, flexicurity and the evolution of labour income share (i.e. the part of value added that is allocated to labour). The report thus continues to inform the broad policy debate on flexicurity, which resulted in a Commission Communication on Common Principles of Flexicurity¹, approved on 27 June 2007, and also provides analytical support to the Commission Communication on Youth² of 4 September 2007.

The key findings of the 2007 report reveal:

- Robust recovery of EU labour markets in 2006 brought a net increase in employment of over 4 million – the strongest performance since 2000. Employment expanded in all of the 27 Member States.
- Youth unemployment, at over 17% in the EU, and difficulties in successfully integrating young people in the labour market continue to be major challenges.
- Developments in employment of older workers are more encouraging; their employment rate is up 7 percentage points since 2000. Integrated policy approaches to active ageing deliver the best outcomes.
- Advanced forms of flexible work arrangements within firms are an important element of successful flexicurity regimes and are also key for learning and innovation.
- Persisting inefficiencies in the provision of, and inequalities in access to continuing vocational training (CVT) financed by enterprises suggest room for improved government intervention in this area. Carefully designed policies can help increase efficiency in CVT provision by securing both investment in and benefits from such training, while ensuring that those most in need participate more actively.
- Developments in the labour income share are driven by interactions between technological progress, labour market institutions and other factors such as openness to trade. However, these factors often have a varying impact on the income share of different skills categories.

¹ COM(2007)359

² COM(2007)498

2. OVERALL EMPLOYMENT PERFORMANCE OF THE EU IN 2006

Against the background of accelerating economic growth, labour markets in the EU made a robust recovery in 2006. After modest increases in previous years, employment growth in the EU-27 picked up significantly in 2006 and, at 1.4%, was at its strongest since 2000. In addition, labour productivity accelerated in comparison with 2005, growing at a higher rate than in the US, although the EU continued to underperform slightly in relation to the US in terms of employment growth.

Progress towards the overall employment rate target of 70%, as well as towards the targets for female (60%) and older workers (50%) has been the best since 2000. The overall, female and older workers' employment rates reached 64.3%, 57.1% and 43.5%, respectively in 2006. Despite this progress, it seems increasingly challenging for the EU to meet the overall employment rate target and the older workers' target within the next four years, although the employment rate target for women seems to be within reach.

For the first time in at least a decade, employment expanded across the entire EU, with all 27 Member States showing a rise in employment. Particularly high employment growth was observed in a number of the new Member States, namely Estonia, Latvia, Poland, Bulgaria and Slovakia, and in Ireland, Luxembourg and Spain. Even those Member States that had no increases in employment in the previous year, namely Germany, Hungary, the Netherlands and Portugal, experienced significant employment growth in 2006.

Overall, there was a net increase of over 4 million people in employment in the EU-27 in 2006, with women contributing slightly more to employment creation than men. With respect to age, prime-age workers accounted for almost two-thirds of the increase, while older workers accounted for just under a third. Despite the widespread rise in employment, large variations persist across countries. In 2006, employment rates ranged from as low as around 55% in Poland to more than 77% in Denmark. At the same time, employment rates for women remain substantially below those for men in most countries. There is also substantial variation in rates for older workers.

3. YOUTH AND OLDER WORKERS IN THE EU: TOWARDS A LIFE-CYCLE APPROACH TO WORK

Youth and older workers are two groups that require a special policy focus. To avoid possible adverse effects on economic growth and reduce the mounting pressure on social protection systems stemming from demographic ageing, the life-cycle approach to work promoted by the European Commission needs to be reinforced. An appropriate policy response must therefore concentrate on increasing labour market integration of all age groups and facilitating transitions over the life-cycle.

More efforts are needed, particularly in education and training policies, to improve labour market outcomes of young people

Youth unemployment and difficulties in successfully integrating young people into the labour market remain a key challenge for many EU Member States. Despite signs of some overall recent improvements, a real breakthrough in reducing youth unemployment has yet to occur. At 17.4%, the average youth unemployment rate in the EU remains high and has not improved relative to the rate for prime-age adults. Furthermore, as a whole, the EU underperforms in an international context, with substantially more young people in

unemployment and fewer working than in other industrialised countries, such as the US, Canada or Japan.

Young people frequently face problems in making a smooth and rapid transition from education to work. A small but significant share of youth remains trapped in temporary, often low-pay jobs from which they find it difficult to exit. Are also at particular risk young people who experience long spells outside employment, education or training. Insufficient educational attainment is one of the main causes behind the poor labour market performance of young people. Therefore programmes which address school failure early on, familiarise youth with the world of work and prepare them for the need for lifelong learning in order to adapt their qualifications throughout their working lives, are a crucial factor to improve the labour market situation of young people. In addition, better integration of those suffering from long spells in unemployment or inactivity will also require more effective activation strategies than in the past. Moreover, young people are among the groups most likely to be negatively affected by institutional settings favouring those with a permanent job at the expense of newcomers. The problems due to labour market segmentation could be partly addressed by making it easier for firms to hire young people.

Integrated policy approaches can help increase participation of older people

Increasing labour market participation of older people and delaying the exit from the labour force represent another important challenge. Currently over half of 55–64 year olds in the EU are inactive, mainly for reasons of retirement but also due to poor health, personal or family responsibilities, or the belief that no work is available.

Recent results indicate that efforts by Member States to implement measures in support of active ageing are starting to produce results. Employment of older workers has been one of the most dynamic components of the EU labour market in recent years, with employment rates for older workers up 7 percentage points since 2000.

Much of the rise in employment rates for older workers is due to the increase in rates for older women, which is in turn due mainly to the knock-on effect of the increasing participation over time of women in general. In contrast, the increase in rates for men is a result of the delays in exiting the labour market, this being more due to such factors as reforms of pension and social protection systems, and other recent measures associated with active ageing.

The recent rise in employment of older workers has not been associated with any noticeable rise in the precariousness of their employment, nor is it mainly associated with an increased prevalence of part-time work or self-employment. Furthermore, much of the employment growth has been in relatively highly skilled, knowledge-intensive sectors, and with a shift away from the more manual occupations towards the non-manual and more knowledge-intensive occupations.

Despite the recent improvement, efforts to promote active ageing must still be pursued vigorously. Labour market participation of older people in Europe remains low by international standards and the employment rate for people aged 55–64 is still 6.5 percentage points from the Stockholm target of 50% by 2010. Different types of approach to active ageing currently exist across Member States. Features of the systems which are more successful in supporting active ageing include good levels of general health for older people and reasonably high standard retirement ages; efficiently designed active labour market policy measures and participation in lifelong learning; flexibility with regard to working hours and

work organisation; and reduced financial pressures on older workers to leave the labour market, both in terms of the financial incentives for older workers to retire and the cost pressure on employers to hire younger rather than older workers. Certain groups of Member States, in particular Nordic countries, have implemented a more integrated approach to active ageing and have been relatively more successful in integrating and retaining older workers in employment compared to others.

Increasing the labour market participation of older workers further will require overcoming the continuing barriers and disincentives they face to employment. A broad range of factors needs to be addressed. Apart from financial incentives embedded in pension systems, early retirement schemes and other elements of the tax and benefit systems, as well as more flexible wage-setting that is less linked to seniority, the general challenges include changing attitudes towards older workers, maintaining and promoting the health and working capacity of workers as they age, and developing the skills and employability of older workers through effective lifelong learning. Suitable working conditions need to be provided, including more flexible working time and work-organisation arrangements, together with employment opportunities for an ageing workforce. It is also necessary to provide a generally supportive environment for active ageing. Addressing gender-related issues is also important, and further efforts to reduce the gap in activity between men and women will be a key element of any strategy to increase the labour supply of older people.

Addressing the challenge of demographic ageing and its impact on the workforce will require the wider implementation of more integrated strategies than has been the case to date. Measures are needed which emphasise the integration of older workers and improve their employability as well as closing off early exit pathways. In taking active ageing forward, particular attention should be paid to promoting access to employment throughout working life. A comprehensive active-ageing strategy must focus on the entire working lifespan and all age groups, not just older workers.

4. FOSTERING FLEXIBILITY WITHIN FIRMS AND SECURING CAREER DEVELOPMENT FOR WORKERS: IMPORTANT ELEMENTS OF FLEXICURITY

The recently adopted Commission Communication on flexicurity³ recognises that flexibility goes beyond the ease or difficulty to hire and fire employees (external flexibility) and can also be provided within the firm, either via flexible working-time arrangements (i.e. internal flexibility) and/or different forms of work organisation, such as teamwork and work rotation (i.e. functional flexibility).

Competitive pressures and technological progress have led many firms in advanced economies to adopt more flexible forms of work organisation, together with complementary human resource management policies. Flexible forms of work organisation are loosely characterised by flatter hierarchical structures, a stronger involvement of employees in decision making, and greater discretion of workers in the completion of their tasks, coupled with richer job content. These innovative working practices show significant complementarities and are more effective when combined with certain human resource management practices, such as on-the-job training and contingent pay systems. However, this does not necessarily imply a convergence towards a single model of the flexible workplace.

³ COM(2007)359

Firms in EU Member States have adopted distinct national strategies of organisational change because of different institutions, socio-political preferences, economic structures, historical contexts, etc.

Employment in Europe 2006 proposed a typology of EU labour markets along the dimensions of flexibility and security. However, flexibility referred exclusively to its external component as measured by OECD's Employment Protection Legislation indicator. This year's report uses data from the European Survey of Working Conditions to compute country-specific indicators of various forms of flexibility provided within the firm in order to update the previously presented taxonomy of EU flexicurity systems.

The analysis strongly suggests that consideration of both external and internal forms of flexibility (and their interaction) is essential to characterise labour markets and flexicurity regimes across the EU. Two regimes are found to be associated with relatively 'good' socio-economic outcomes. The first regime (mainly 'Anglo-Saxon' countries) is characterised by high external flexibility combined with average levels of advanced forms of internal flexibility. It displays high labour mobility, low segmentation, moderate intensity of vocational training, low spending in activation policies, a moderate success in reducing poverty, and low budgetary costs. The second regime (mainly 'Nordic' countries plus the Netherlands) is characterised by advanced forms of internal flexibility (complex tasks, workers' autonomy, flexible working-time arrangements), combined with moderate levels of external flexibility. It is also associated with good economic outcomes (labour market, productivity, innovation) and a strong reduction in poverty rates, but involves higher budgetary costs. Everything considered, there is no single combination of policies and institutions to achieve and maintain good socio-economic results, but rather different pathways to good performance that are, to a large extent, the result of distinct historical trajectories.

The quality of working conditions depends on the form of flexible work organisation adopted by the firm. The advanced internal flexibility (or discretionary learning) model, which combines greater demands on workers, in terms of responsibilities and problem-solving activities, with increased autonomy at work, may represent a win-win solution, reconciling both employers' and employees' interests, particularly when combined with better support for workers moving between jobs and enterprises. In fact, it is simultaneously characterised by firms' enhanced performance and better working conditions compared to more traditional forms of work organisation. On the other hand, more basic forms of functional flexibility, such as task rotation, teamwork and strict production norms, may be detrimental to job satisfaction, work-life balance and work-related health outcomes.

The way work is organised plays a key role in the absorption and creation of knowledge. Models characterised by discretion at work combined with complex problem-solving activities are the best performing with regard to the development of in-house innovation, while the so-called 'lean' model, characterised by a low degree of autonomy and a large emphasis put on task rotation and teamwork, tends to be associated with the adoption and/or modification of existing technologies. Workers' involvement in understanding and solving production-related problems seem, therefore, to be a key factor for learning and innovation activities, in addition to completion of 'standard' education (i.e. secondary education) and/or participation in continuing vocational training.

Continuing vocational training is an important component of flexicurity as it enhances job-to-job mobility both within and across firms, and secures workers' career trajectories

Developed economies have experienced important long-term structural changes over recent decades. These included a transition from a model of production based on mass production to a new paradigm driven by quality and innovation, accompanied by major sectoral shifts in the economy and a significant increase in the level of educational attainment of the workforce. This has strengthened the need for continuing vocational training (CVT) in order to guarantee that workers who entered the workforce several decades ago have the skills required to participate effectively in today's economy. These trends also put increasing pressure on new generations of workers who have to continuously acquire the necessary skills to learn and innovate in a new era characterised by rapid change.

There are four main reasons for the strengthening of CVT in the context of the Lisbon Strategy. First, CVT policies can reduce social exclusion and income inequality caused by insufficient human capital by raising the skills and employability of workers at risk. Second, they can assist in retaining older workers longer in the labour market, thereby helping support the financial sustainability of social protection systems. Third, policies targeted towards CVT are a crucial ingredient for the implementation of flexicurity policies by making internal labour markets more dynamic in the context of economic changes, and workers' skills more transferable among employers, while making workers' careers more secure. Finally, these policies can help ensure that workers acquire and upgrade the skills necessary in an era characterised by rapid change and learning, making European enterprises more competitive in a knowledge-based and globalised economy.

There are some indications that the free market cannot provide an efficient level of investment in CVT because of possible market failures, in particular in relation to the poaching of workers. This refers to the possibility that workers leave their current employers who provided the training in order to join other employers who did not pay for the training, but gain part of the rewards. In many circumstances, such market failure does not provide adequate incentives for employers to invest in CVT.

Empirical findings indicate that some groups of employees have a lower likelihood of participating in employer-sponsored training than others in the EU, particularly older workers, the less educated, those in precarious jobs and those in the lowest part of the income distribution. This has a negative impact on the employability of these groups, and hence increases the risk of social exclusion and income inequality. It also undermines the sustainability of social protection systems by increasing the probability of workers retiring at an early age. Furthermore, the likelihood of participation in training remains quite low in small enterprises, which has a potentially negative effect on the innovation activities of this important business segment.

For these reasons, government intervention in the form of provision, regulation or funding may be required to ensure progress toward the two traditional objectives of education and training, efficiency and equity⁴. However, when implementing policy instruments, governments have to find the right balance among these forms of intervention in order to achieve both efficiency and equity.

⁴ Efficiency and equity in European education and training systems; COM 2006 (481)

Specially designed policies may contribute to reducing under-investment in CVT at the initiative of the enterprise, while, in certain circumstances, improving equality of access to training for all workers. These policies include fiscal incentives and subsidies, collective labour agreements and compulsory agreements through levy-based schemes. When designing such policies, governments should, nevertheless, be careful to avoid possible adverse effects on the efficiency of resource allocation.

Supply-side policies may also help secure the benefits of CVT. Reforms aimed at aligning productivity and wages should be considered with caution because they may reduce the benefits from CVT that accrue to the employers providing such training to their employees, even though they may have positive effects on the demand side. On the contrary, policy instruments aiming at reducing turnover, such as payback clauses, may be useful since, to a certain extent; they allow employers to secure the benefits of their investment in CVT. Lastly, policies promoting quality assurance, accreditation and certification of training may have differentiated effects. Whilst accreditation contributes to improving the information on the quality and nature of training, thereby helping employers to take training decisions, certification of training may reduce firms' incentive to provide CVT to their employees, as it increases the transferability of their skills. On balance, however, these policies are socially desirable, as they can ease job mobility, thus contributing towards implementing flexicurity policies.

5. LABOUR INCOME SHARE: TECHNOLOGICAL CHANGE, GLOBALISATION AND SKILLS

The labour income share, which measures the part of value added that is allocated to labour, started to decline in most EU Member States shortly after the first oil price shock and is currently below levels attained in the 1960s. The available data also shows that the share allocated to skilled workers rose steadily since the 1980s while that allocated to unskilled workers declined progressively.

The socio-economic importance of these developments can hardly be underestimated as the labour income share has an impact on personal income distribution and social cohesion, the direction of the adjustment in wages and employment, and the composition of aggregate demand, touching thus upon important issues of equity, economic efficiency and macro-economic stability.

The evolution of the labour income share itself is the outcome of the complex interaction between technological progress, labour market institutions, and, to a lesser extent, other drivers, such as openness to trade. Moreover, depending on the degree of substitution between the production factors, changes in one of these drivers may have a significant different impact on the income share of the different skill categories.

Econometric analysis shows that technological progress made the largest contribution to the fall in the aggregate labour income share in recent decades. However, this loss was unevenly spread over the different skill-types as high-skilled workers increased their share while low-skilled workers saw their income share fall. Trade openness also had a negative impact on the aggregate labour income share but to a lesser extent than technological progress.

In order to contribute to rebalancing of the distribution of value added between capital and labour and between the different skill categories of labour, policy-makers need to pursue macro-economic policies oriented to stability and growth, creating an economic environment

that contributes to further capital and technological progress. However, in order to realise this potential, it is imperative that these policies are complemented by labour market policies that take into account the varying responses of the different skill categories to these drivers and, most importantly, by policies that allow the low-skilled to progress to a higher skill level so that the adverse effects, which stem from their high degree of substitutability with capital, can be mitigated. Some degree of employment flexibility within a secure context should facilitate the creation of new jobs and the destruction of those that become unproductive, as well as facilitate the swift progression of workers to more rewarding jobs rather than keeping them trapped in low-skilled jobs, the income share of which is adversely impacted by capital deepening and technological progress.

6. CONCLUSIONS

The analysis presented in this report demonstrates how a strategic and integrated policy approach towards key priority areas - such as flexicurity and a life-cycle approach to work - can make a difference to the labour market performance of the Member States. This has a particular relevance for both young people and older workers.

Life-long learning remains a necessary ingredient of successful policy packages, and this year's report highlights the policy solutions that improve both efficiency and equity in vocational training. The report also examines the much-debated issue of developments in the labour income share in the EU and suggests some policy responses aiming to mitigate their possible adverse effects. Overall, the findings of the report support the general direction of the main policy initiatives at EU level within the employment pillar of the re-launched Lisbon Agenda.

The improved economic climate of 2006 should by no means deflect attention from the urgent need for a continued labour market reform across the EU. On the contrary, this cyclical improvement should provide an opportunity to design and implement the structural changes needed to achieve a breakthrough towards the overarching Lisbon objectives of full employment, quality and productivity at work, and social and territorial cohesion.

The "Employment in Europe 2007" report is published under the following website:
http://ec.europa.eu/employment_social/employment_analysis/employ_2007_en.htm