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## **The European Employment Strategy**

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# **The European Employment Strategy: A new form of governance of labour markets in the European Union**

## **Abstract**

The European Employment Strategy has been put in place in order to ensure the survival of the European Social Model in view of institutional change resulting from the introduction of the European Monetary System. It has become the platform of a system/method of open coordination (OMC) of social and employment policy. It represents a new method of governance through soft law, as the traditional governance scheme of binding directives could not find the acceptance of MS in core areas of national policy development and implementation.

The EES promotes flexibility and risk taking in order to foster innovation and employment while at the same time diversifying the system of social protection to act as a safety net for the individual (flexicurity). The innovative governance method has been designed to solve increasingly complex employment and social policy challenges of post-industrial globalised societies, which are marked by greater diversity of the production system and the work force. The EES has contributed to the preservation of social and labour standards, thereby raising the productive capacity of the workforce as well as the well being of the individuals and the society.

As the EES is only a management instrument to raise the effectiveness and efficiency of the functional mechanisms of the supply side of a socio-economic system, it can not create employment and promote economic growth in its own right. Coordination with macro-economic policy, in particular fiscal and monetary policy, is just as much in need as the promotion of investment in R&D and coordinated wage policy to raise the innovative capacity of the EU-MS and thereby promote economic and employment growth in the long run.

## **Keywords**

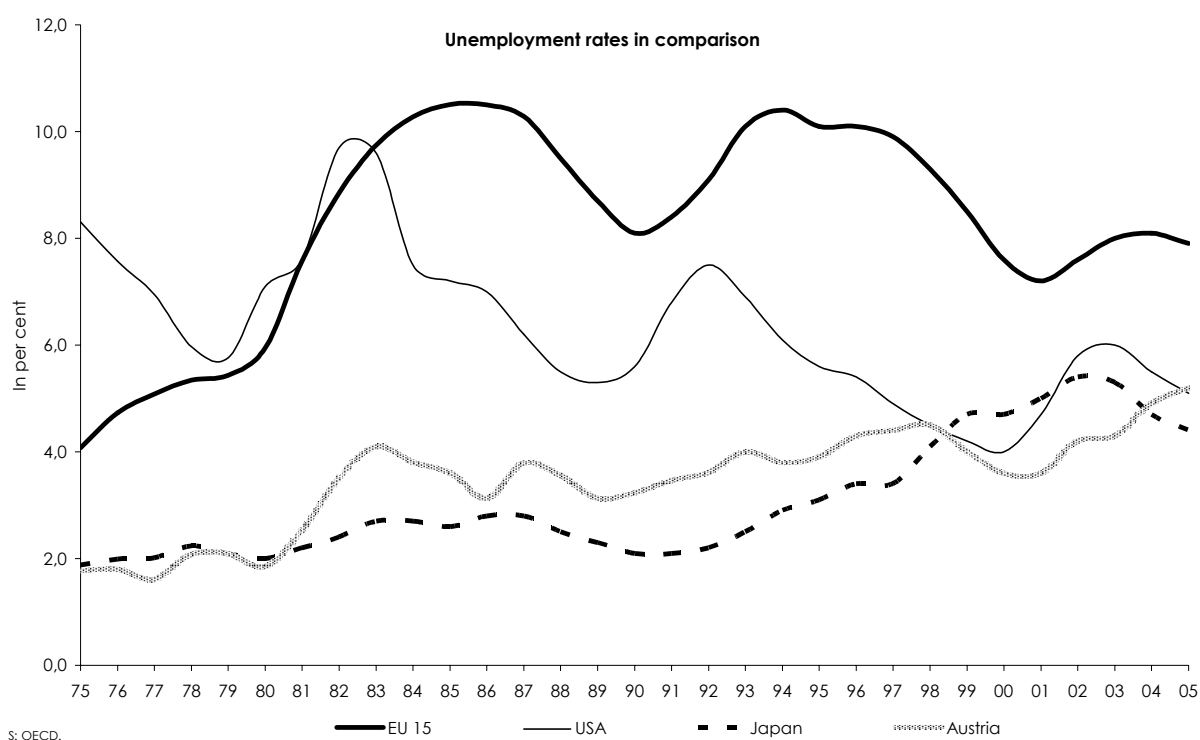
European Social Model, Open Method of Coordination, Soft Law, National Reform Programme, Supply side management.

## Introduction

By the mid 1990s, unemployment rates in Europe reached socially and politically unsustainable levels. With an unemployment rate of 11 percent on average in the EU-15 in 1994, voices gained weight, suggesting that there was a link between the Single Market and the bad employment performance of Europe (Graph 1).

In order to appease critics of increased economic and political integration of Europe and to gain support for the creation of the European Monetary Union (EMU), the preservation of the European Social Model moved centre stage in European policy development. It is in this light that the European Commission under Jacques Delors issued the White Paper on Growth, Competitiveness and Employment (COM 93). This White Paper set the scene for the European Employment Strategy (EES), which engages all EU-MS in a process of coordination of employment and labour market policies and concomitant institutional change.

Graph 1:



The EES is an acknowledgement that in a united Europe the employment problems of the individual MS can not be resolved by the traditional instruments of every MS. Apart from the intrinsic value of concerted action on EU-level to combat high and rising unemployment, the EES was seen by many as a necessary complement to measures leading up to European Monetary Union. EES was also about getting public support for the EURO.

In order to enforce common employment policies, the EC was in search of innovative governance methods, as it became increasingly difficult to get directives<sup>1</sup> approved in areas which remained under the sovereignty of the MS (subsidiarity of employment and social policy).

By the time of the Amsterdam Intergovernmental Conference, a process of multilateral surveillance – which had been put in place to ensure economic convergence<sup>2</sup> before the implementation of the Euro – had become an accepted and successful instrument to reach agreement on convergence policies. The system of national plans, Peer Reviews and recommendations lent itself for adaptation to employment and labour market policy. Thus, by proposing this governance system as a vehicle for coordination of employment policies, the chapter of employment in the Amsterdam Treaty could find acceptance by all MS.

The Amsterdam Agreement, which was signed in 1997 and came into effect in 1999, is the first corner stone of the institutional reform process<sup>3</sup>, which addresses socio-economic institutions as diverse as education, labour market and social protection systems.

In its White Paper on Governance (COM, 2001), the European Commission asserts that institutional reforms are a necessary response to the increased socio-economic and political integration and interdependence between EU member states resulting from the implementation of a Single Market and the Single Currency. The latter represent a change in the paradigm, i.e., a change of economic incentive systems, for every member state, thus reducing the internal consistency of the national institutional architecture<sup>4</sup>. As the functional mechanisms of decision-making differ in the face of a different set of institutions, the outcomes may also differ as a result of different motivational forces which are guiding institutions and socio-economic actors. Thus, the argument goes, national incentive frameworks of socio-economic and political agents no longer operate efficiently in the face of increased economic integration of the EU. *Kohler-Koch* (2005:3) goes so far as to say that "... European 'good governance' may threaten the governability and democratic quality of established national systems."

This paper examines to what extent the new form of governance of the EES, in particular the Open Method of Coordination (OMC) of employment policies, is successful in combating unemployment in Europe. First, the process of policy development and coordination is looked into, followed by a short account of its impact on incentive systems and labour market

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<sup>1</sup> Traditional European governance is built around the imposition of more or less uniform rules for all MS in the form of directives, COM (2001).

<sup>2</sup> The Maastricht Treaty established convergence criteria which MS had to abide by if they wanted to become eligible for membership in the EMU. <http://europa.eu/scadplus/leg/en/lvb/l25014.htm>

<sup>3</sup> Following *North* (1990), the EU acknowledges the importance of institutions for economic growth.

<sup>4</sup> On the diversity of models of social organisation and the resulting differences in incentive systems in Europe see *Soskice* (1999), *Hollingsworth – Boyer* (1997), *Aoki* (1995).

performance. A concluding section raises the question if there is a price to be paid in terms of foregone economic and employment growth by preserving the European Social Model.

## **The implementation of the European Employment Strategy**

The EES has the achievement of full employment as one of its objectives. The policy mix open for coordination in the EU is, however, limited and leaves out important elements of employment policies, which are pillars of the functional mechanisms of national labour markets, in particular industrial relations and wage policy<sup>5</sup>. The EES is basically a supply-side strategy to supplement macro-economic policies which promote economic growth (in the main fiscal and monetary policy) and thereby labour demand.

The EES is applied in countries with as diverse historically grown institutions of the labour market as Sweden, the UK, France and Italy, every one of those countries representing a distinct model of social organisation as pointed out by *Esping-Andersen* (1996). Not surprisingly, the labour market and social policy outcomes differ between those countries as a result of different incentive systems emanating from a different set of institutions, taxes and socio-economic systems (*Biffi*, 2004, 2007). Hence, in order for the EES to be effective in terms of employment creation, a significant convergence of labour market and social institutional arrangements is required.

The steps taken by the EES towards this end are complex, necessitating interactive, multi-level policy coordination and development which engage many levels of government, social actors (NGOs), the Commission, the Council of Ministers and academics. The instruments decided upon by the Council of Ministers to meet the objectives of the EES – higher employment rates, more active labour market policies, more employment intensive economic growth, systems of flexicurity, equal opportunities – are centred around employment guidelines. The first guidelines, nineteen in total, which give specific meaning and content to concepts and ideas, were approved in December 1997. They are formally structured around four pillars:

- Employability,
- Entrepreneurship,
- Adaptability,
- Equal Opportunities.

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<sup>5</sup> More about the factors sustaining collective bargaining and social rights in Europe in *Biffi – Isaac* (2005).

Every member state is to draw up a National Reform Programme<sup>6</sup> (until 2005 National Action Plans), incorporating instruments and methods to combat unemployment and promote employment. These programmes are planning documents, indicating the road to be taken in the next year, and reporting documents to evaluate progress made in the past year. The implementation of policies is monitored on the basis of annual country reports, which, by using common input and output indicators, render policies transparent. The efficiency of instruments and measures (inputs) and the success of the outcomes are carefully examined and evaluated by independent agents in the member countries. The policy input/output coefficients provide insight into the efficiency of various policy instruments. The reporting and monitoring system provides ample information on measures which work and which do not work, it raises awareness about problems which have not been taken into account to begin with and/or which evolve in the course of integration, globalisation, technical and socio-economic change. Consequently, the scope of the guidelines widens and the knowledge base on the functional mechanisms of labour markets improves.

An annual Joint Report reflects upon the employment in Europe and the achievements of the EES<sup>7</sup>. The Commission has significant power by guiding the process of co-ordination of employment and integration policy. By 2000, i.e., at the occasion of the Lisbon summit, the Council went beyond giving policy guidelines by starting to set targets. The Council agreed upon the benchmark of an employment rate of 70 percent (of the 15-64 year olds) by 2010 (currently 65 percent). Another target was introduced, i.e., that at least 20 percent of the unemployed are included in active labour market policy measures, e.g., education and training or employment subsidies. Thus, the EU-employment strategy introduces competition between the member states by developing benchmarks for employment creation and reduction of unemployment, in particular long-term unemployment. This may be one objective of the European Commission, since research studies suggest that intergovernmental competition increases governmental responsiveness to its citizens and creates more efficient state and local governments.

The overall strategy of the EES is, to preserve the European Social Model by reforming it. It does that not by traditional legal changes (directives) but by soft law, which aims to hit a compromise between hard core neo-liberal promoters of the 'minimal state' and the defenders of a social democratic powerful state. Thus, the EES represents something like a 'third way' by promoting flexibility and risk taking in order to promote innovation and employment while at the same time diversifying the system of social protection to act as a safety net for the individual (flexicurity), (Kenner, 1999). According to Sabel (2000) the EES is an innovative governance method, which is capable of solving employment and social policy challenges of increasingly diverse post-industrial globalised societies; *Jenson – Pochet*

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<sup>6</sup> For an overview of the pertinent EU documents, the National Reform Programmes since 1998, and the guidelines in the various pillars refer to: [http://ec.europa.eu/employment\\_social/employment\\_strategy/national\\_en.htm](http://ec.europa.eu/employment_social/employment_strategy/national_en.htm).

<sup>7</sup> For a list of reports see [http://ec.europa.eu/employment\\_social/employment\\_analysis/employ\\_2005\\_en.htm](http://ec.europa.eu/employment_social/employment_analysis/employ_2005_en.htm).

(2002) point out that the EES is a move away from the objective of a Single European Labour Market with high and uniform social and employment standards. They acknowledge, however, that the fears of the opponents of a Single Currency that it would destroy the Social Model have not materialised. As a matter of fact, the preservation of social and labour standards is increasingly seen as an important factor of supply side management promoting productivity and economic growth.

### **Unbalanced performance of the EES**

While the open method of coordination has been an important tool to implement activation policies of the unemployed at the expense of passive measures, to promote the reform of public employment services and to reduce the gender wage gap, i.e., objectives under pillar one and four, it has not been as successful in encouraging entrepreneurship and the adaptability of the work force and employment system. This is particularly true for Austria. This is due to the often difficult integration of other ministries with the Labour Ministries into the system of policy coordination. In MS with a well established social partnership concept, inroads were being made towards a reduction of taxes on unskilled and low wage labour while at the same time raising minimum wages to make work pay. While some MS, in particular the UK and the Nordic countries, managed to offset the reductions in revenue by raising taxes on energy, this was not the case in countries like Austria.

Two of the best examples of a positive impact of the EES, are the modernisation of public employment services (*Biffli, 2000, European Commission, 1998*) and the development of territorial employment pacts (TEPs).

As public employment services were given a key role in the implementation of the employment guidelines, the EES gave priority to the modernisation of these services. Jobmatching is the core business of the Public Employment Service (PES). Another important feature is the implementation of labour market policies to reduce the mismatch between labour supply and demand. Furthermore, the PES provides information about labour market developments. Since the PES administers and pays out unemployment benefits, registers jobseekers and job vacancies, it has a good insight into the development of labour markets and thus plays an important role in rendering labour market mechanisms more coherent and easily understood. Information about the labour market is a source of empowerment of every actor in the labour market. It is a public good which increases the efficiency of the job matching process and ensures equitable access to information.

In order to promote geographic mobility within the EU, the European Employment Service (EURES) was established in 1993. It took a slow start but is becoming an increasingly important instrument of organised labour mobility within the EU. Increasing cross-border mobility of seasonal workers from Germany to Austria in the wake of the 'Hartz' laws has become an important source of labour for Austria since the early years of 2000. This latest experience



indicates that to optimise its potential, EURES needs to become strongly rooted within the different national PESs.

The reformed PES also played a key role in the development of TEPs. In Austria, the PES – referred to as the Labour Market Service (LMS) – is a key partner in every Territorial Employment Pact, i.e., an institutional partnership of the main socio-economic institutions and actors developing and executing labour market policies at local level<sup>8</sup>. TEPs are social pacts which constitute a specific form of heterarchical governance, linking labour market policies with regional socio-economic development plans. They promote mutual understanding between the various socio-economic actors of local governments and provide opportunities for cross-disciplinary learning<sup>9</sup>. TEPs are integrated in a larger national and EU-wide framework of the EES, i.e., they are integral parts of the National Reform Programme, thereby linking vertical and lateral institutional settings and development strategies.

The Austrian experience suggests that TEPs are partnerships which evolve over time such that their impact can only be judged after a certain passage of time (*Huber, 2001, 2003*). In Austria, TEPs have become increasingly important institutional partnerships focusing on regional labour market problems, providing the necessary bridges between institutions for organising and financing further education and training in line with regional industrial employment and growth strategies. They also provide the necessary expertise to ensure a flow of funds from the EU structural funds thereby promoting regional economic development. So far labour market policies, in particular activation measures, have been in the forefront of policy coordination. The development of social services and entrepreneurship has been limited, however, as it would imply a change in the national tax and transfer system which currently tends not to promote marketisation of household production, in particular care work (*Biffi, 2007*).

All that said, the implementation of the EES has contributed to a change in paradigm in Austria, away from the promotion of early exit routes from the labour market towards increased participation of mature workers, as well as a shift away from passive labour market policy measures towards activation measures. The implementation of TEPs as an innovative element of local governance has raised awareness amongst local players of the interrelationship of economic and employment policy and created understanding for the need of equal opportunities legislation and its implementation in order to ensure socio-economic participation of groups of persons which otherwise tend to fall by the wayside or tend to be discriminated against. It has, however, not been able to provide impetus to economic and employment growth. This is not surprising in view of the limited scope of the

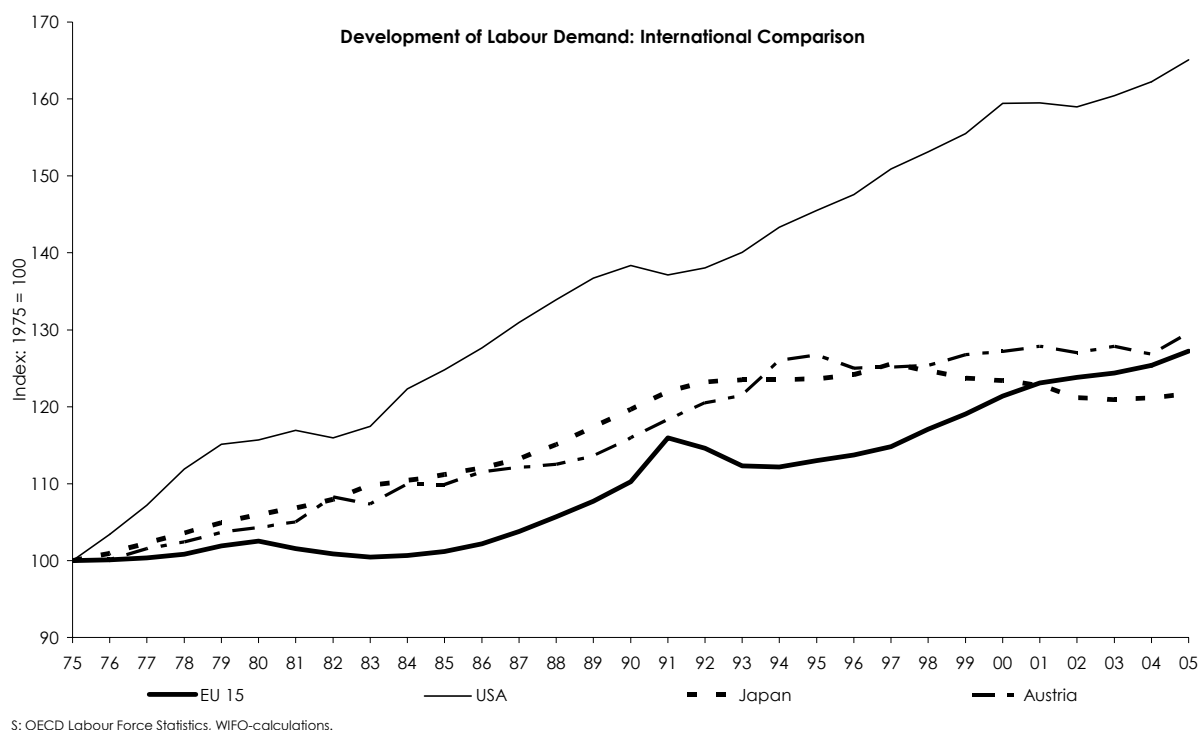
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<sup>8</sup> For more insight into the complexity of such partnerships see information on the largest TEP in terms of population covered, i.e., Vienna : [http://www.pakte.at/attach/Mappe\\_2005\\_EN\\_final\\_W.pdf](http://www.pakte.at/attach/Mappe_2005_EN_final_W.pdf).

<sup>9</sup> *Scharpf* (2001) points out that policy learning is an important ingredient of the efficiency and effectiveness of policy development and implementation.

EES. While it improves the functional mechanisms of the labour markets by increasing transparency, reducing transaction costs and wastage of resources, promoting the efficiency of matching an increasingly diverse labour supply and demand, and by raising the effectiveness of policy through targeting, it can not on its own create demand (Graph 2). It can at its best raise the productive capacity of the work force but in an economy which is moving towards the technological frontier, as is the case of Austria, more efforts have to be put into R&D and entrepreneurial activities and into innovative systems of social organisation, which promote the marketisation of household services, to effectively raise employment and economic growth in the medium to long run.

Graph 2:



## An economists viewpoint on co-ordination of policy

There is one strand of orthodox economic theory, which argues that unfettered market mechanisms, i.e., a return to laissez-faire politics of the 19<sup>th</sup> century, will eventually bring about full employment (Friedman, 1962, Friedman, 1980). The assumptions underlying this policy proposal are based upon partial equilibrium theory, the theory of the firm, according to which demand for labour increases, if the wage rate declines. According to this view unemployment is the result of wrong relative prices and it can be reduced by cutting the wage rate. Thus it has been maintained that undue (downward) rigidity in wages and welfare

provisions in European countries have resulted in significantly higher unemployment rates in those countries compared to the US (*R. B. Freeman, 1994*). Another orthodoxy propounds that unemployment is the result of insufficient aggregate demand and can be overcome by embarking upon measures, which result in significant increases in aggregate expenditure<sup>10</sup>.

A gap persists, in spite of long-standing attempts to find the bridge between micro- and macro-economic theory<sup>11</sup>, between the neo-classical theory of the firm and macro-economic theories, which are concerned with employment, money, inflation, the business cycle, and economic growth. The role of different markets and their interplay in the determination of output, employment, prices, income distribution is not very clear. Both micro-economic theory and macro-economic theory suggest, however, that unemployment may be a result of co-ordination failure. In the last two decades, evolutionary economics (*Foster, 1987, C. Freeman, 1982*), the economics of institutional change, contemporary management theory, as well as game theory (*Gale, 1995*) are starting to address the issue of co-ordination failure, which is the basis for the EU policy agenda. Old controversies in the development of economic thought are taken up; which lead to a reformulation of economic theory, particularly in the field of organisational change, human resource allocation, and entrepreneurship. Evolutionary economic theory, which has a macro and micro side, introduced a critical reappraisal and examination of the role of institutions in economic development. It is the economics of institutional change which provide the theoretical rationale for the co-ordination of policy within the EU.

Social capabilities, captured in institutions, be they political, commercial, industrial or financial, are the vehicle through which adaptability of nations to changing socio-economic frameworks is assured. Adaptability to new requirements is thus identified as an important factor in economic and employment growth. The notion of adaptability suggests that there is an interaction between social capability and technological opportunity. Technological opportunity drives change; if countries learn to modify their institutional arrangements they may take advantage of the technical opportunities and thereby improve the economic performance and well-being of their societies<sup>12</sup>. Amartya Sen goes beyond this concept of capability and extends it to an institutional framework which offers every person the opportunity to develop his/her capabilities, i.e., to empower the individual to actually do something (functional freedom) to improve one's situation (*Sen, 1985*). Such a regulatory system does not only promote individual wellbeing but also the productive capacity of the society. This aspect of capacity building is an important driving force for promoting individual

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<sup>10</sup> Apart from Keynes and his *General Theory* *Kaldor (1980)*. More recently, see *Solow (1997)*.

<sup>11</sup> They span from *Lester (1946)* to *Phelps et al. (1970)* and *Layard – Nickell – Jackman (1994)*

<sup>12</sup> *Abramovitz (1989)* points out that growth by itself can entail serious social costs by dislocating people from their established occupations and living conditions, apart from damaging the environment. Social and environmental sustainability ask for co-ordinated socio-economic policy to limit damages to the social and physical environment.

empowerment, continued education and training, improvements in the health and safety measures at work (OH&S)<sup>13</sup> and the European Social Model in general.

*Calmfors – Driffill* (1988) identify differing industrial relations systems as one factor, which makes a difference in economic performance, *Powell* (1991) identifies networks, supplier-producer-distributor chains, trust etc., which reduce complex realities and assure fast reaction to changes in the socio-economic environment. *Olson* (1982) points out that obstacles to change may be linked to vested interests, established positions, customary relations among firms and between employers and employees. The extent to which they are enshrined in institutions, laws, codes of honour etc., has implications for the speed of adaptation to new requirements.

The "Economic Theory of Clubs", expounded by *Buchanan* (1965), addressed the issue of exclusion from certain economic activities by law, or by tradition, of certain individuals or groups of persons, and the economic growth implications thereof. The 'public choice theory', which developed out of the early writings of Buchanan, bridges the gap between economics and politics and provides one pillar of an evolving theory of institutions. It makes us aware of the fact that government is not a monolith but composed of many competing legal entities, each with its own agenda. The concept of private competition is applied to the relations between the different units of government. Scarce resources are the cause for rivalry among government units, horizontal or vertical, which is not without impact for the development of employment, education and training, health care, housing etc. Bringing inter-administrative conflicts to the fore and introducing it into the body of economic theorising has enriched economic thinking and brought it closer to reality.

Orthodox economic theory deals almost exclusively with the market economy, thus implying that economics may be separated from politics and various entrenched institutional arrangements. The EU, however, makes a bridge between markets and social organising mechanisms. The solution to the unemployment problem is seen in bringing together the key actors: labour, firms, provider organisations for social security, governments, finance institutions, NGOs etc., to address the issues involved and to devise co-ordinated solutions, which find general acceptance. Transaction costs symbolise in some sense the institutional structure of the economy, and are an element in the efficiency of socio-economic processes.

According to *Denzau – North* (1994: 4) '... institutions are the rules of the game of a society', which 'consist of formal and informal constraints constructed to order interpersonal relationships'. They offer ways of co-ordinating conduct among interdependent agents. Unemployment may, in the light of the new theoretical developments, be the result, at least partly, of a process constraint and not of wrong relative prices or levels of effective demand. In view of the increasing complexity of labour markets, in particular the fragmentation of

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<sup>13</sup> More on the increasing awareness of the importance of OH&S for a healthy workforce and the change in governance to improve OH&S in *Smismans* (2006).

production, the increasing specialisation of work processes and the increasing diversity of skill requirements of the workforce, longer search processes may go a long way to explain increasing levels of unemployment. If a country does not adapt its institutional framework quickly enough to the new requirements, search costs may increase to such an extent that an economy and society may become locked into a Pareto-inferior equilibrium (*Arthur, 1990*).

When individual conduct depends on what others do, in particular a critical mass of others, then co-ordination is needed, if a particular outcome is the objective. The market mechanism, such as it is, left to itself, is unable to undertake this task successfully. For co-ordination to be successful, public policy support is essential.

## **Conclusions**

In the light of the above, the co-ordination of policy within the EU can be expected to have an influence on employment and unemployment in the MS. The EU goes beyond the orthodox economic analysis and policy prescription of the OECD 'Jobs Study' (*OECD, 1999*), by allowing institutions a wider role in employment creation. It is understood that the quality and distribution of institutions are politically determined, and do not obey the rationale of the price system. It is the institutions, which the EU wants to influence by its employment policy agenda.

The theoretical link between employment, unemployment, and economic growth is much more complex than suggested by mainstream economic theory in that social, political and institutional factors play an important part in the functional mechanisms of markets (*Streeck, 1995*). It is acknowledged that unemployment is influenced by factors on the demand side and the supply side. The co-ordination of policy affects basically the supply side. This may not be enough to find the road back to full employment.

To ensure social cohesion and prohibit social dumping, the introduction of wage and price co-ordination systems in an EU-context could be an important aspect of a full employment policy agenda of the EU in future. But then, maybe, this is the next step to be taken. However, the following question needs to be answered in connection with the implementation of the wage policy agenda: 'Is the EU an optimum wage bargaining area'? We can say that, so far, the EU has managed to lower unemployment steadily since the introduction of co-ordinated employment and social policy and socio-economic exclusion has been combated. But the EU has not become an area of fast economic and employment growth. It is struggling to preserve a distinct welfare system in the wake of globalisation. This is the road to take in order to maintain social cohesion. But will it be at the cost of loss of European competitiveness against the rest of the world?

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