

## Social and Employment Policies

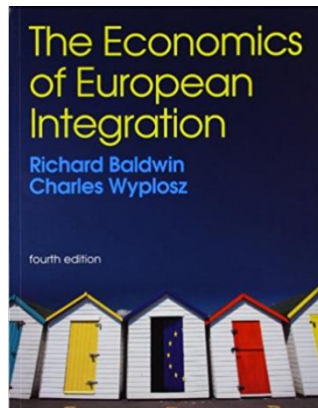
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# OUTLINE

- I. Components of Social Policy
  - II. Economics behind Social and Employment Policies
  - III. Characteristics of European Labour Markets
  - IV. European/EU Social Policy
  - V. Challenges of Deeper Monetary Integration
- 
- Readings:
    - Baldwin, Wyplosz: pp. 207-236
    - Kvist, J. (2013): The post-crisis European social model: developing or dismantling social investments? Journal of International and Comparative Social Policy



# I. Components of Social Policy

# Components of social policy

- Labour market regulation
  - Employment conditions (job protection, working hours, vacation days, minimum wages, etc.)
  - Equal treatment of men and women
  - Young employees
- Social expenditures
  - Direct payments (old-age pensions, disabled and health benefits, housing subsidies, etc.)
  - Insurance arrangements (unemployment benefits, sickness benefits, etc.)
  - Active labour market policies (wage subsidies, retraining, etc.)
- Relationship between workers and employers (industrial relations)
  - Wage bargaining
  - Extensions of collective agreements
  - Codetermination (representation of workers in company boards)
- Subsidiarity test = *What role in social policy should be assigned to the European level?*

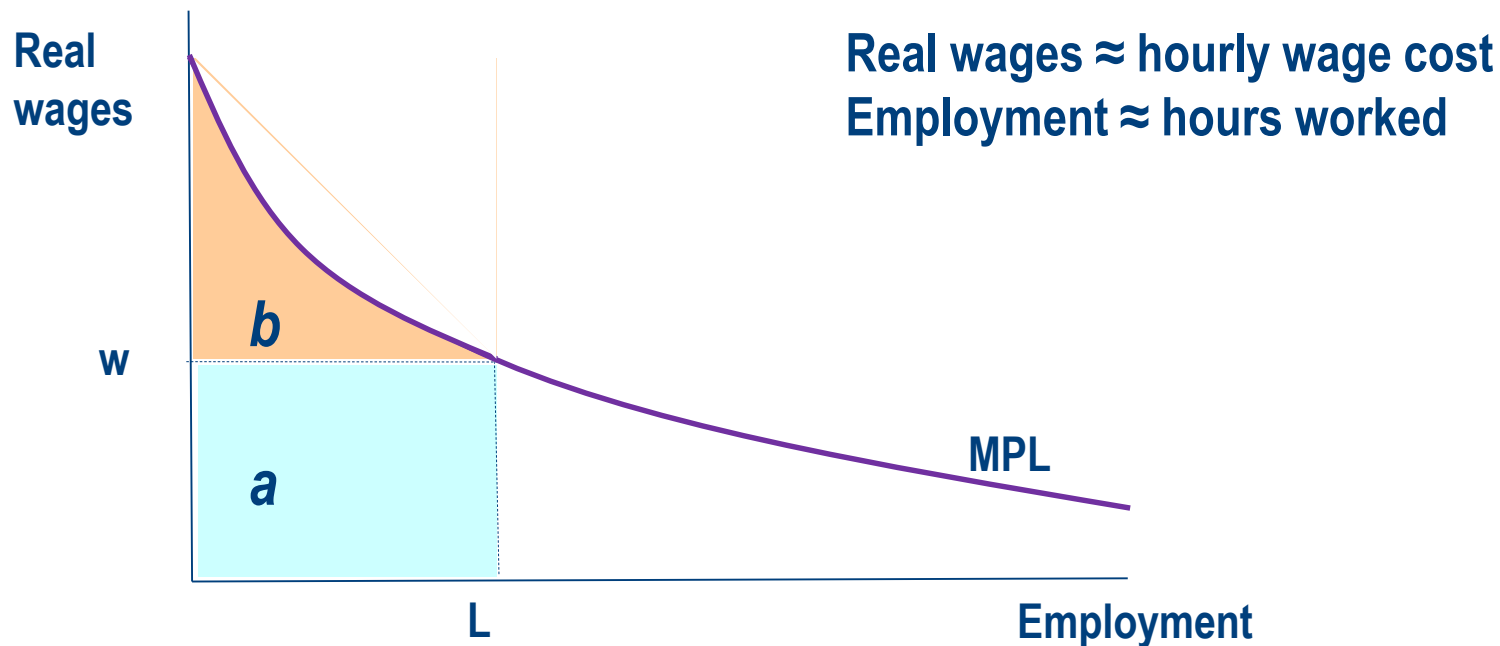
## II. Economics behind Social and Employment Policies

# Labour economics: demand and supply side

## ■ Demand side

- Jobs exist because firms employ people.
- Firms look at the cost and the benefit when deciding whether to hire an additional worker.
- **The Cost:** wage and various contributions (for example to health, unemployment, retirement, etc.).
- **The Benefit:** the additional level of output that the worker will deliver = Marginal Productivity of Labour (MPL)..., MPL declines as more hours are being performed  
=> downward-sloping curve MPL
  - (i) more workers have to share the limited amount of equipment available in the firm
  - (ii) longer hours mean that workers get tired; equipment is used up faster and breaks down more often

# Distribution of income between labour and capital



- **MPL** – marginal productivity of labour = the amount of output produced by an extra unit of labour  $\Rightarrow$  declines as the total amount of labour employed increases
- The area under MPL curve gives total output of the economy
- MPL ... marginal product of labour
  - $a + b$  ... value of total production
  - $a$  ... payment to labour
  - $b$  ... payment to capital (residual variable)

## ■ Supply side

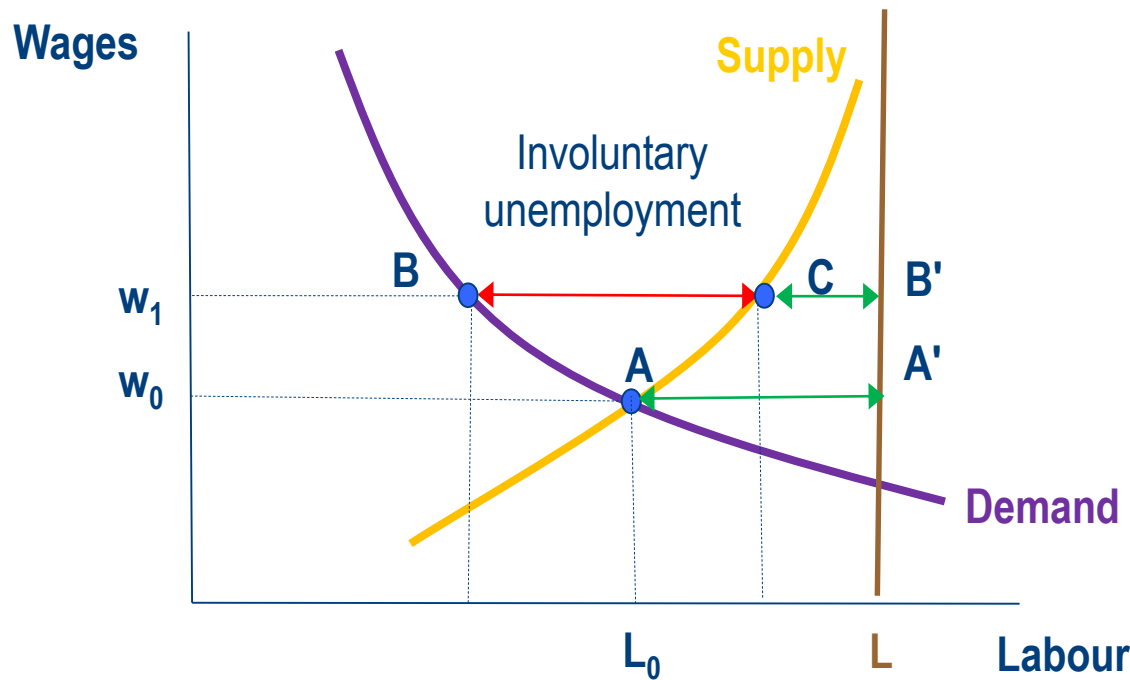
- Labour is supplied by people...
- Work is tiring and less pleasurable than leisure => this is why we ask for remuneration 😊
- How much we ask? => depend on **our skills and personal characteristics**
- The supply curve of labour can be represented by an upward-sloping curve, because:
  - **Worker is unemployed** (ignoring existence of unemployment benefits) => almost any salary is better than nothing (...but minimum wage)
  - **Worker works quite a lot** => one more hour is not that attractive and it will take a fairly good salary to convince her to stay longer on the job.



# Labour market concepts

- Working age ( $N$ ) = Labour force ( $L$ ) + Drop-outs ( $O$ )  $\Rightarrow N = L + O = E + U + O$ 
  - Working age = 15 - 65 years-old
  - People discouraged by searching are counted in  $O$  whereas they should be in  $L$
- Labour force ( $L$ ) = Employed ( $E$ ) + Unemployed ( $U$ )  $\Rightarrow L = E + U$ 
  - Unemployed people have no job but are actively looking for one
  - Black market is part of  $U$  whereas it should be in  $E$
- Unemployment = Involuntary + Voluntary  $\Rightarrow U = U_i + U_v$ 
  - Involuntary  $U$  = people willing to work but cannot find a job
  - Voluntary  $U$  = people refusing to work under given wages
- Participation rate  $\Rightarrow p = L / N = 1 - O / N$
- Unemployment rate  $\Rightarrow u = U / L$
- Employment rate  $\Rightarrow e = E / L = 1 - u$

# Demand and supply side



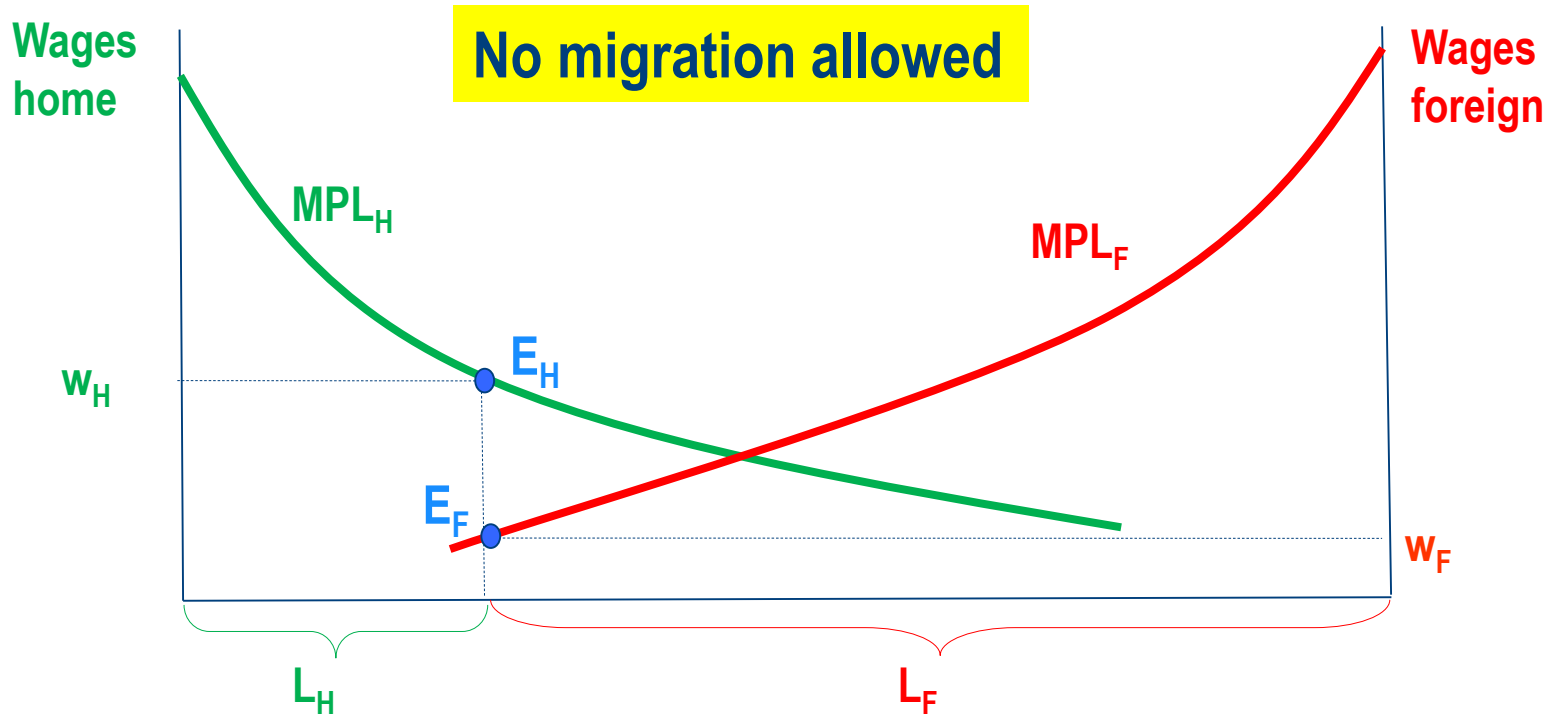
$AA'$  = voluntary unemployment  
 $CB'$  = voluntary unemployment  
 $BC$  = involuntary unemployment

- **Point A:** equilibrium, i.e. firms and workers are perfectly satisfied with the situation, i.e. the total number of work ( $L_0$ ) corresponds precisely to what workers are willing to supply at the going wage ( $w_0$ ). But, that does not mean that every worker has a job or that every employed person works full time.
- **Point B** (the challenge is to understand, why such an outcome is possible)
  - Labour market is special => wages not move up and down (especially 😊) => other markets move back to A
  - Reasons: (i) salaries are not set as the price of oil or corn (bidding process, usually ones per year), (ii) the existence of minimal price (minimal wage), (iii) employment benefits, (iv) unemployment benefits, etc.

# Market rigidities

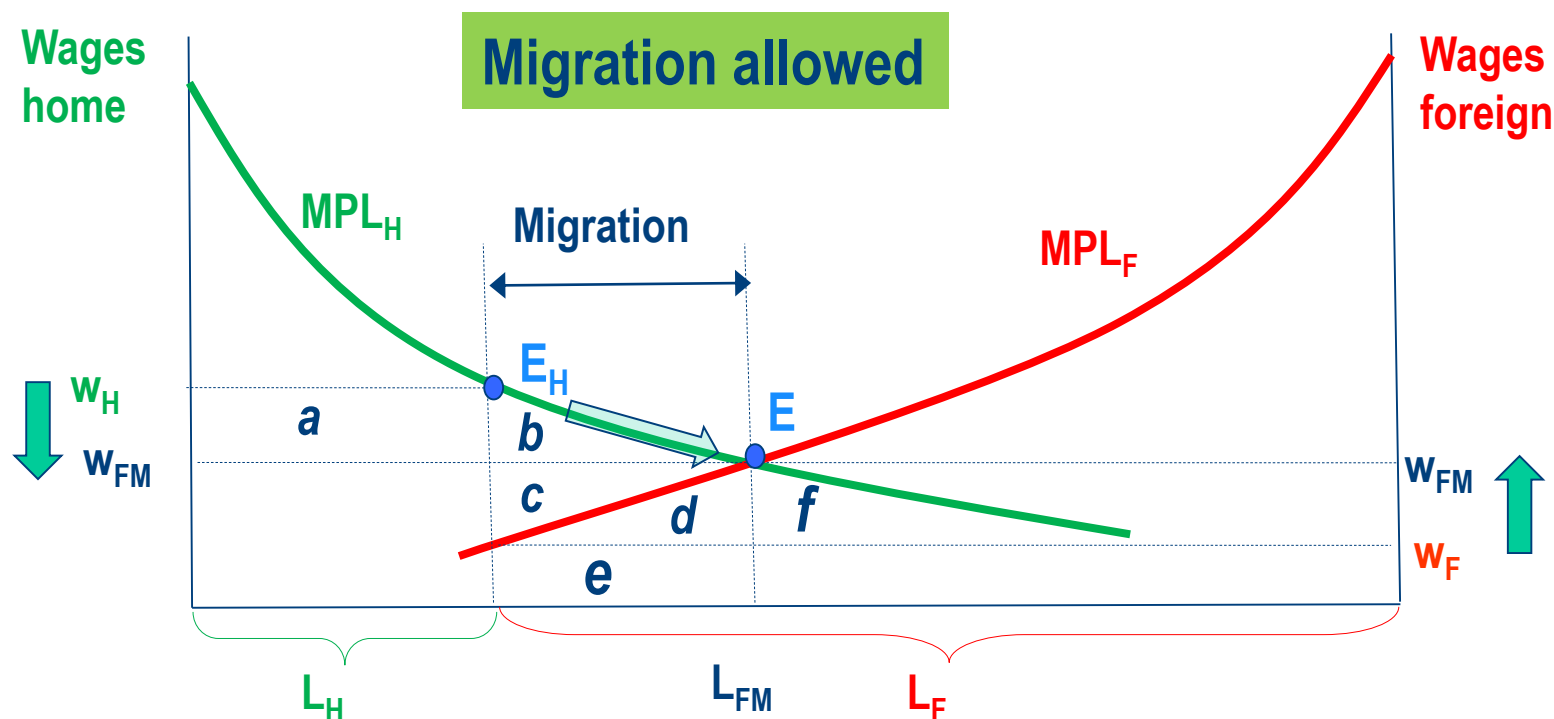
- Working conditions are highly regulated by law and collective bargaining
- Market failures
  - Abuse of excessive market power ⇒ wage distortions created by dominant firms and dominant trade unions
  - Information asymmetries ⇒ difficulties in proper monitoring of labour contracts, individual work effort, contributions to productivity, etc.
  - Negative externalities ⇒ impact of work professions on health and job security
- Broader social considerations
  - Equal education opportunities and decent working conditions are seen as human rights, different ability of people to perform in LM, high unemployment increases crime and insecurity, losing job affects whole family
- Social dumping argument
  - Incentives of firms to locate in countries with lowest cost of social protection
  - Countries with higher social standards may be forced to reduce these standards
  - Worries about the „race to bottom“

# Two countries: Benefits from LM liberalisation



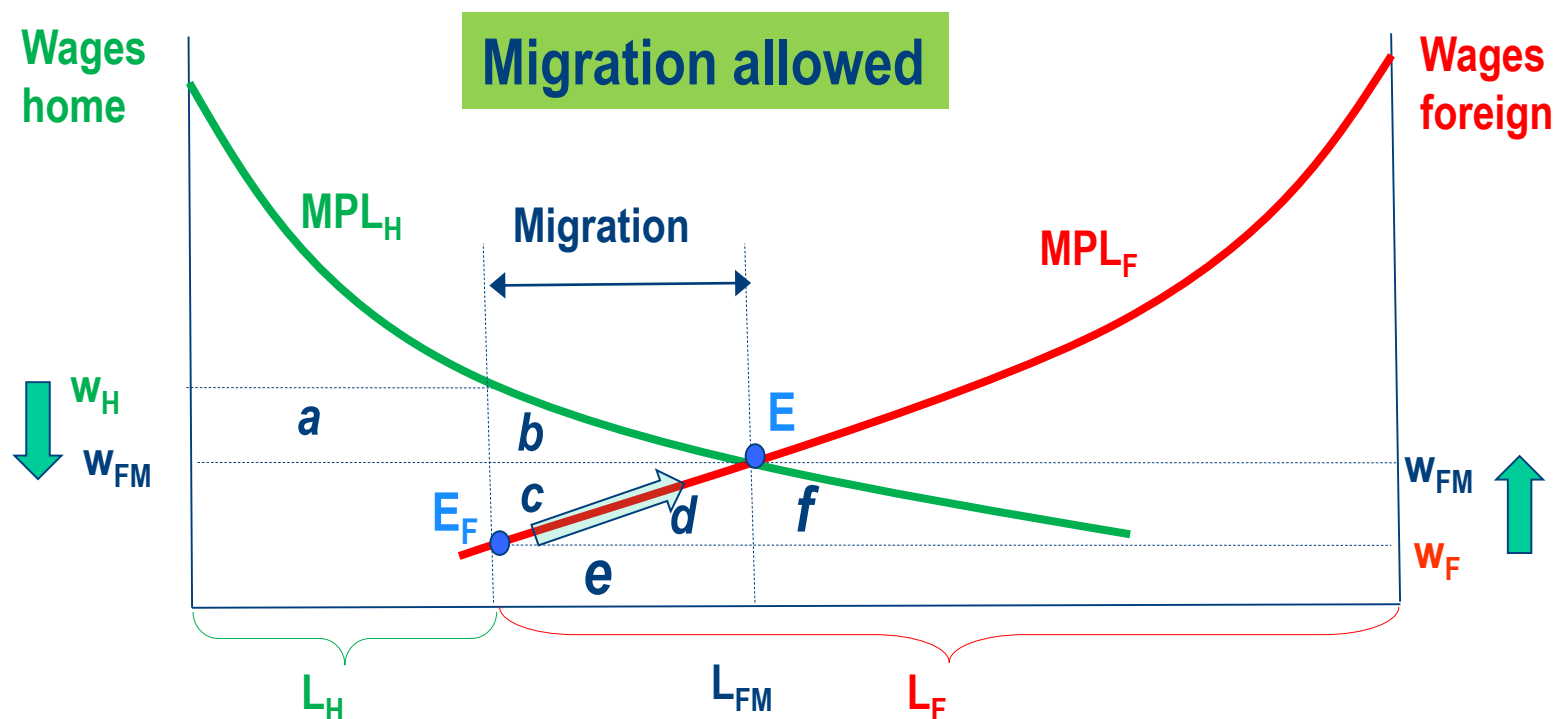
- Initial situation:  $\Rightarrow$  workers in home (H) earn more than workers in foreign (F)  
 $\Rightarrow$  Home equilibrium =  $E_H$  and Foreign equilibrium =  $E_F$

# Two countries: Benefits from LM liberalisation



- **Migration allowed:** labour will flow from Foreign to Home  $\Rightarrow w_H \downarrow \wedge w_F \uparrow \Rightarrow$  harm the home workers; while benefiting home capital owners (and opposite happens in foreign).
- **Effects on home economy** (from  $E_H$  to  $E$ ): losses for labour ( $a$ ): decline in wages, gains for capital owners ( $a+b$ ),  $\Rightarrow$  **total net gain =  $b$**   
(another way: immigrants workers raise total output in Home by  $b+c+d+e$ , but  $c+d+e$  goes not to „native“ workers  $\Rightarrow$  **net gain  $b$** )

# Two countries: Benefits from LM liberalisation



- **Migration allowed:** labour will flow from Foreign to Home  $\Rightarrow w_H \downarrow \wedge w_F \uparrow \Rightarrow$  harm the home workers; while benefiting home capital owners (and opposite happens in foreign).
- **Effects on foreign economy (from  $E_F$  to  $E$ ):** workers in Foreign ( $w_F \uparrow$  because workers move to Home  $\Rightarrow$  gain  $f$ )  $\wedge$  production falling in Foreign (lose  $d$ ) but
- there are gains for emigrants, i.e. foreign workers used to earn ( $e$ ), now they receive ( $c+d+e$ ), so they gain ( $c+d$ )  $\Rightarrow$  but because of lose  $d \Rightarrow$  **total net gain =  $c$**
- Convergence of wages and unemployment rates in home and foreign countries

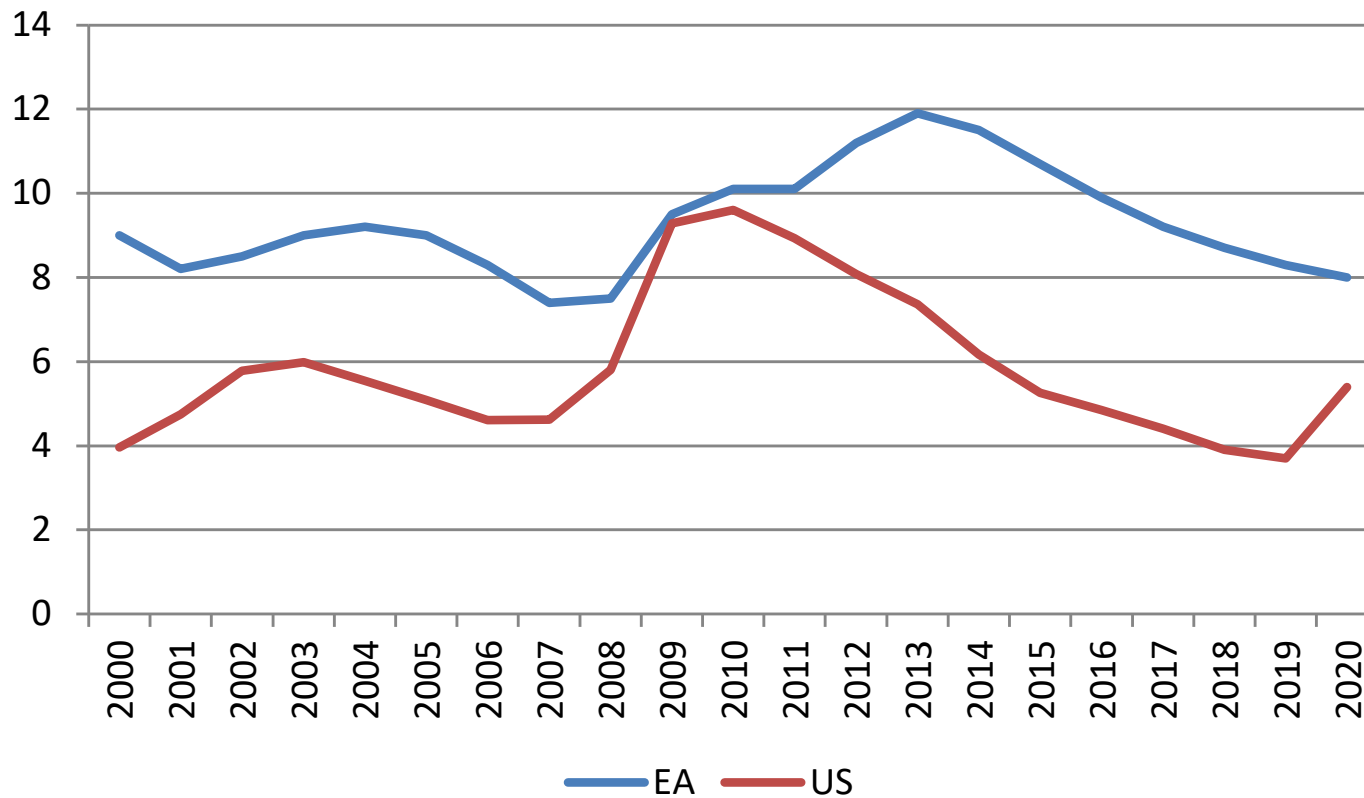
## III. Characteristics of European Labour Markets

# Characteristics of European labour markets

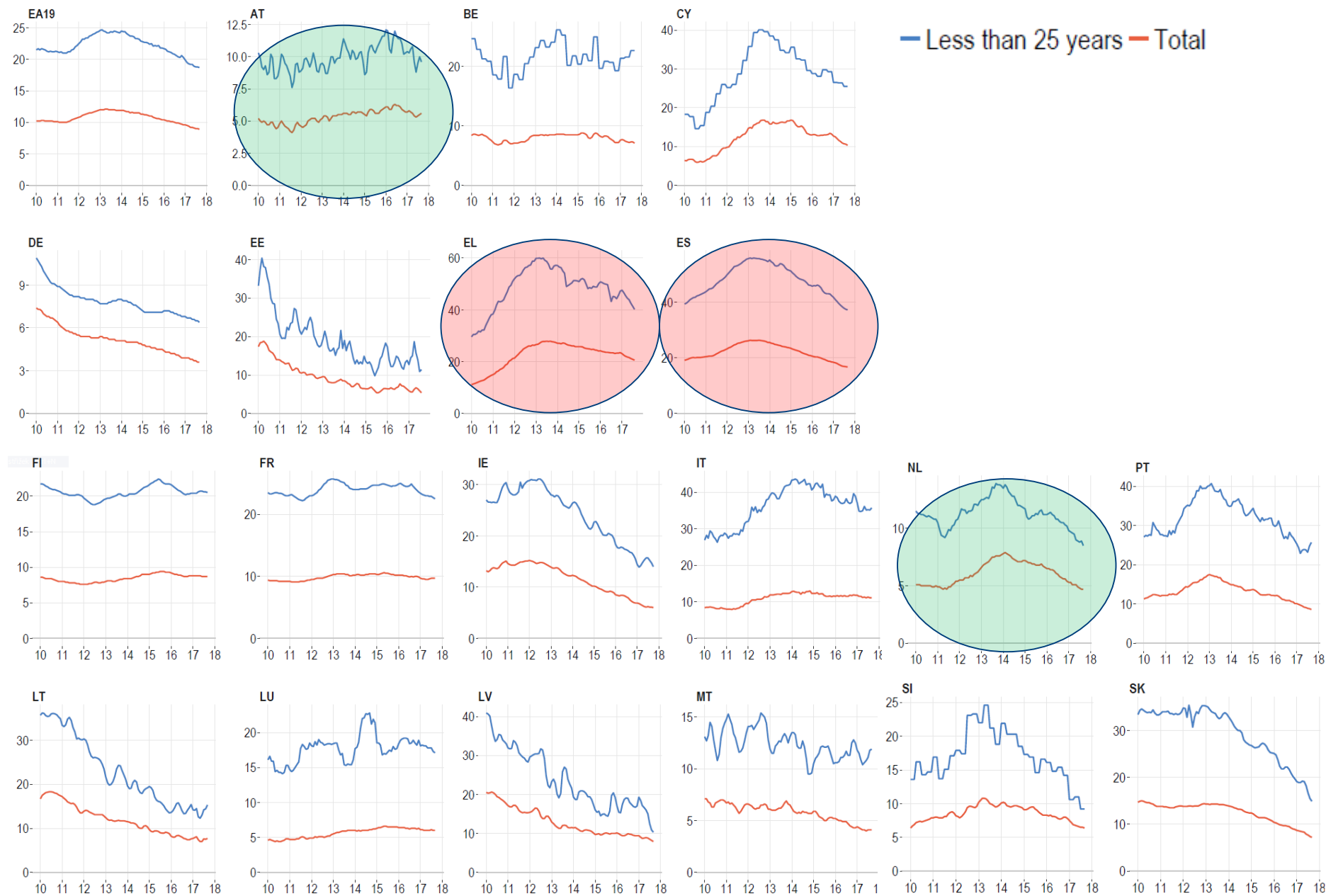
- US economy as a benchmark  $\Rightarrow$  European labour markets are inflexible and rigid
- Relatively high unemployment rates
  - General tendency towards higher unemployment rates unrelated to business cycle fluctuations
  - Difficult recovery from adverse shocks
- High rate of long-term unemployment
  - People out of work for one year or more
  - Labour markets do not allow people to find jobs easily
- Relatively low participation rates
  - Large segments of population do not work (unemployed, not trying to find a job, participation in black market)
- Aging of European population
- Dilemmas of labour markets reforms
  - Pursuing greater flexibility is met with resistance and augments feeling of social insecurity
  - Further constraints are imposed by low-growth climate and concerns about sustainability of public finances
  - How to reform and be re-elected?



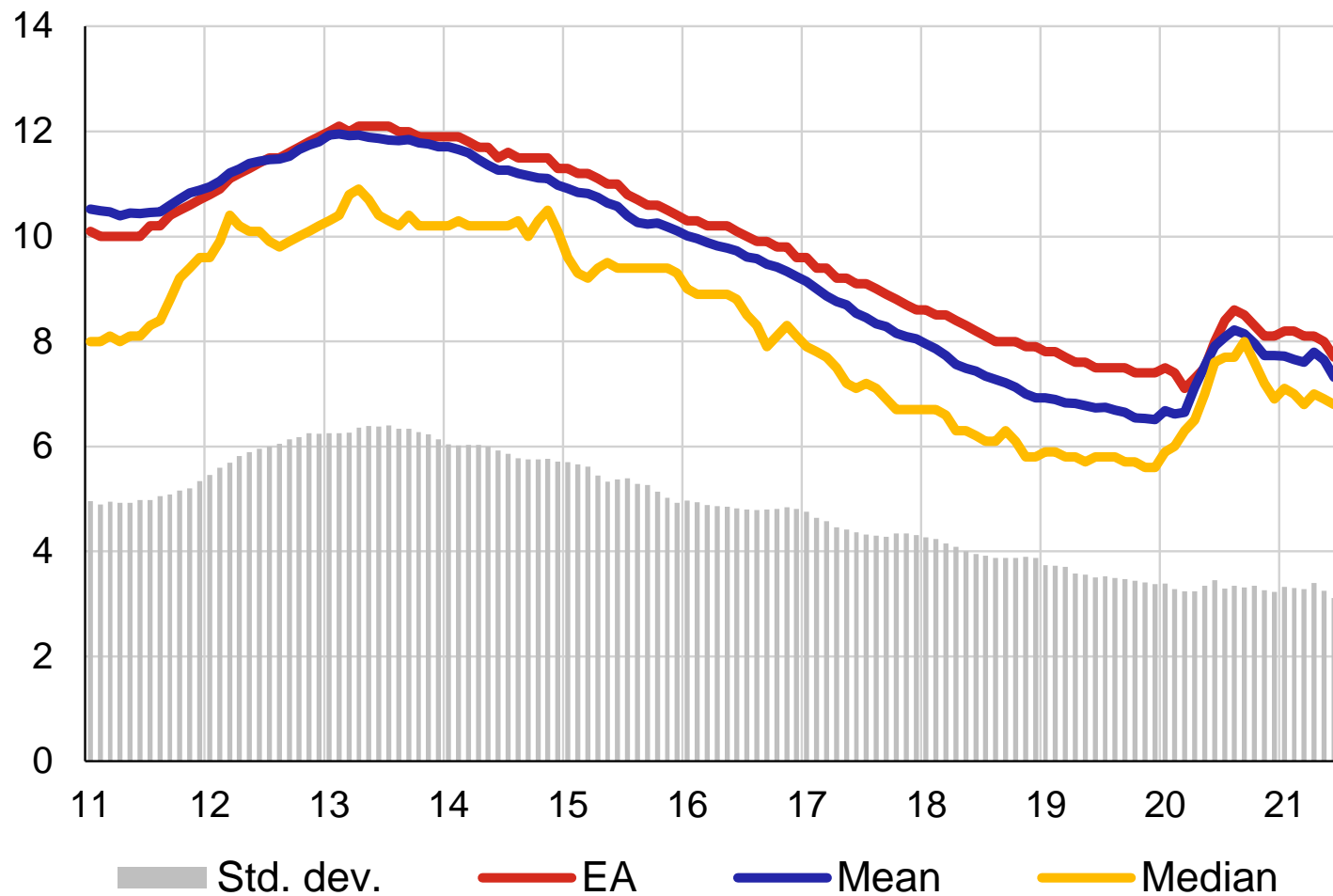
# Unemployment rate EA versus US (in %)



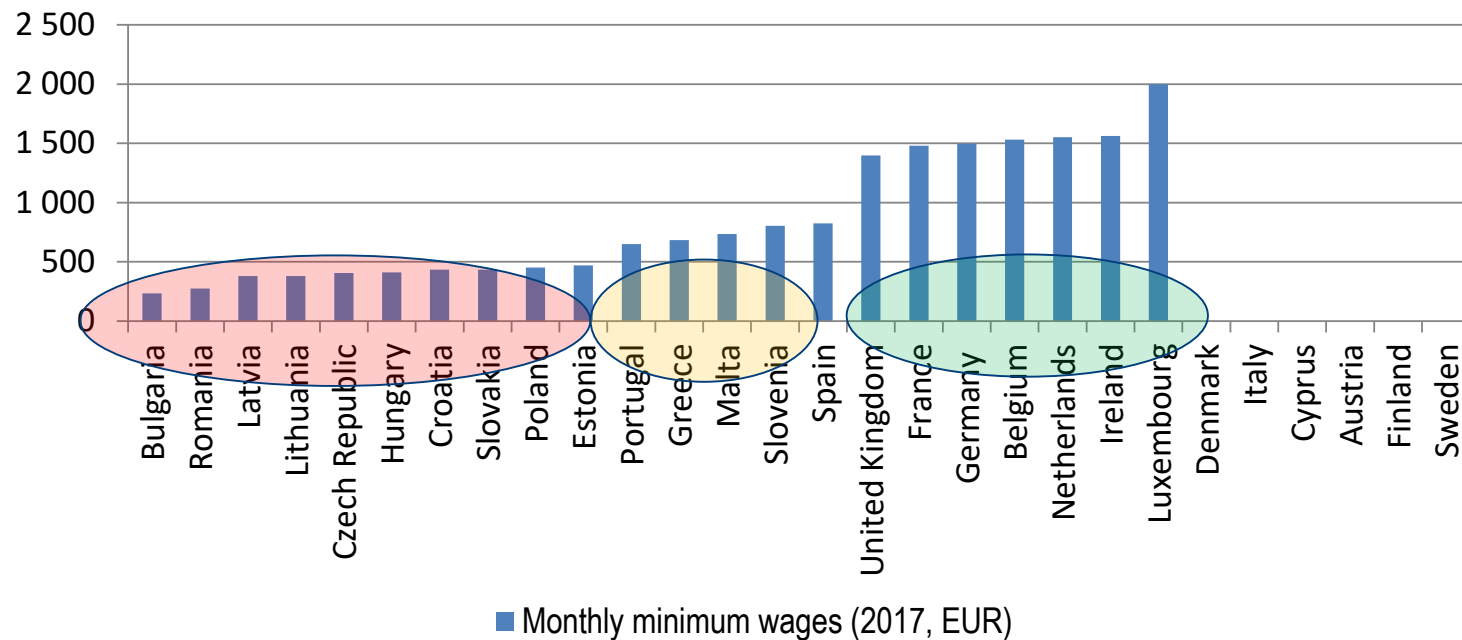
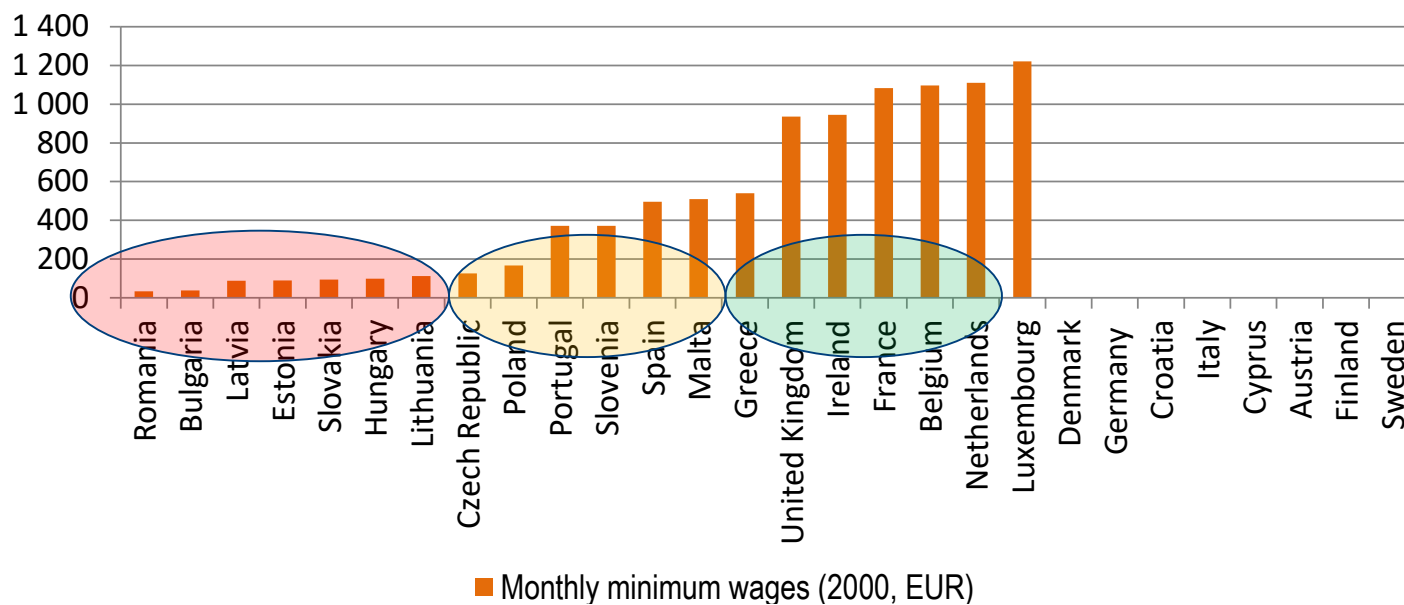
# Unemployment rate in the EA (in%)



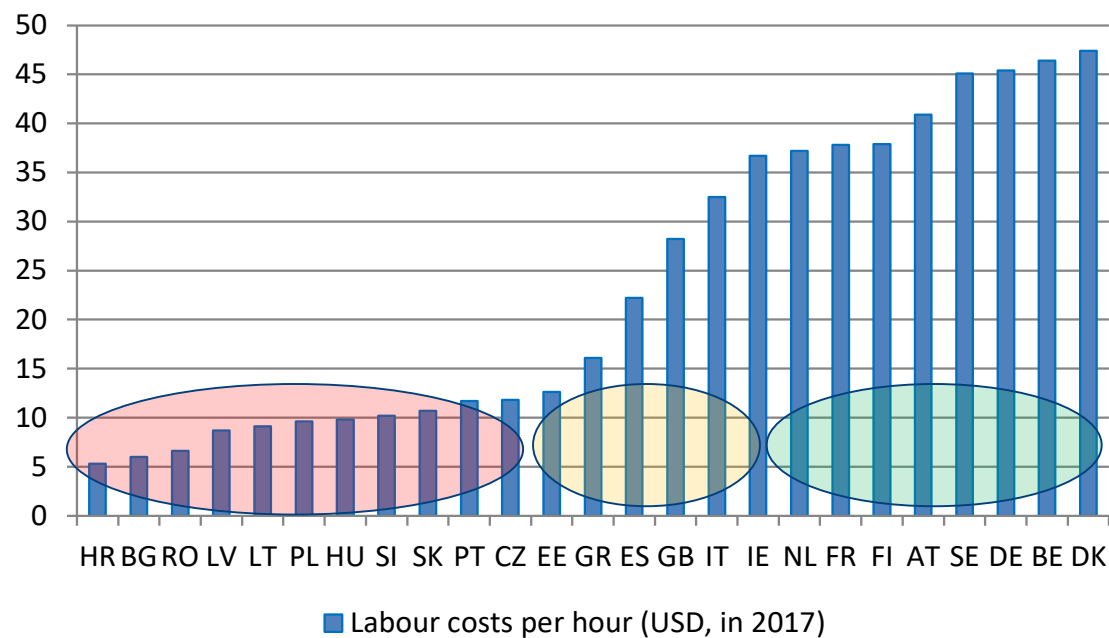
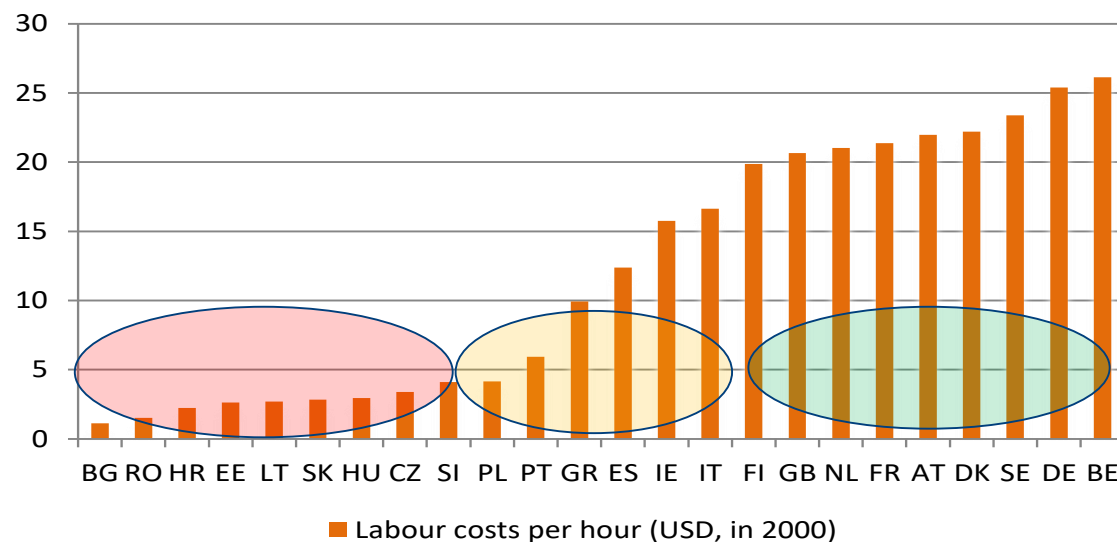
# Unemployment rate (%) – divergence among EA



# Monthly minimum wage (EUR)



# Labour cost per 1 hour (USD)



## IV. European/EU Social Policy

# Typology of European social models

## ■ I. Nordic (Denmark, Finland, Sweden, the Netherlands)

- High taxation and social spending, **strong redistribution**
- Soft hiring and firing regulation coupled with generous unemployment benefits (*flexicurity*)
- Active labour market policies

## ■ II. Anglo-Saxon (Ireland, UK,)

- Large safety net with basic level of benefits, **moderate redistribution**
- Active labour market policies, tough conditioning of benefits
- Relatively pronounced inequality of incomes, „working poor“ phenomenon

## ■ III. Continental (Austria, Belgium, France, Germany)

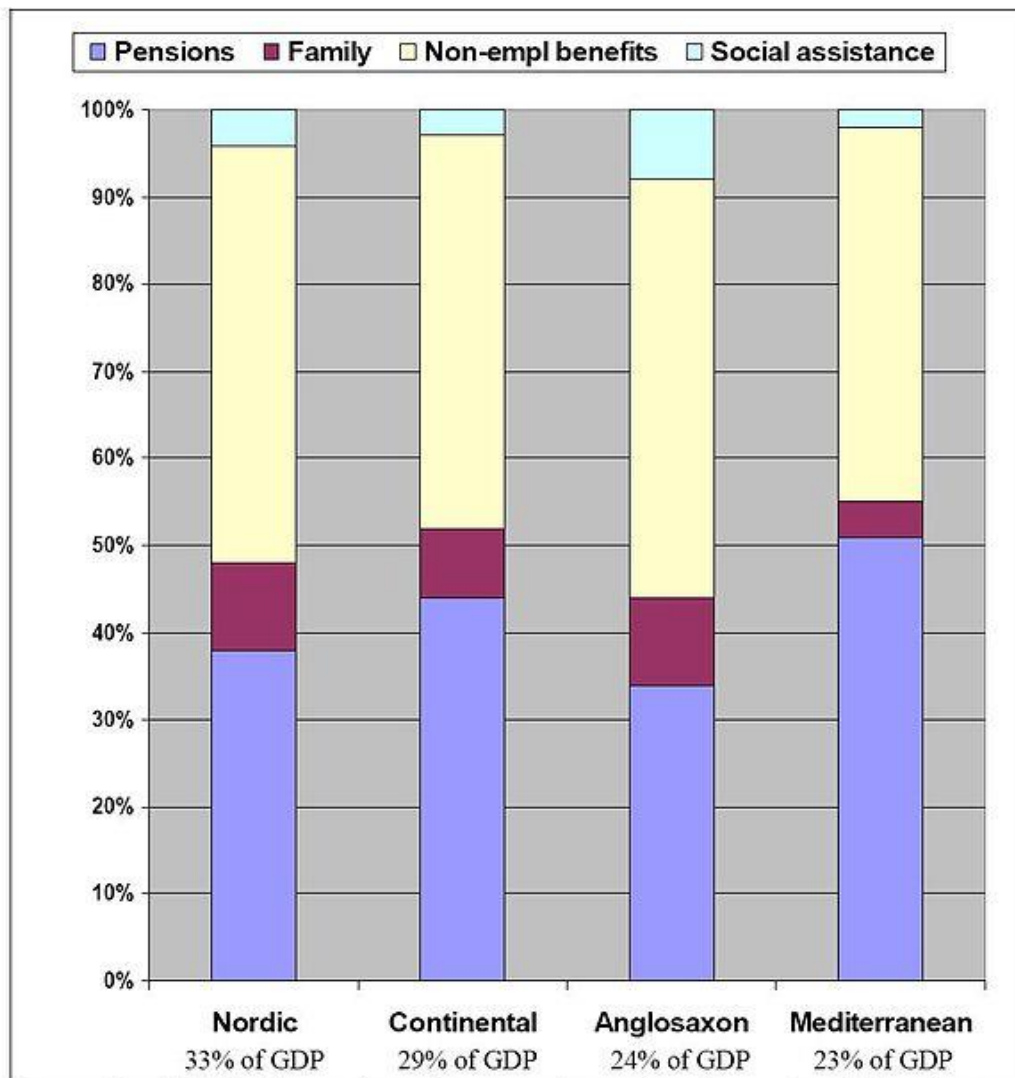
- Considerable social spending, **moderate redistribution**
- Wide role of collective agreements
- Strict employment regulation, generous unemployment benefits

## ■ IV. Mediterranean (Greece, Italy, Portugal, Spain)

- Social spending focused on pensions (prominent early retirement)
- Strict employment protection, low unemployment benefits
- Compressed wage structures

# European social models

Social Expenditure in the EU as of 2000



Source : Boeri (2002). The graph was done using the graph in that article and therefore is approximative.

## ■ A system of transfers:

- From rich to poor
- From young to old
- From employed to unemployed
- From a healthy to ill



- **Obstacles / Barriers to EU social policy**
  - Huge differences in national welfare systems
  - Different ideological conceptions about the role of the state in the economy
  - Different socio-economic traditions in individual member states
  - Unwillingness of member state to give up national sovereignty
- **Perspectives of EU social policy**
  - **Employment policies** are going to remain almost entirely in the hands of MS
  - EU social policy can only serve as a complement to national measures
  - Huge gap between European rhetoric and what the EU level is exactly doing in social issues

# Evolution of EU social policy (1)

## ■ Early years

- Ambitious objectives set out in Rome Treaty: free movement of workers, improvement in working conditions and standards of living, equal opportunities for men and women
- High growth and low unemployment in 1960s did not press on fixed timetable for actions
- Principal EEC activity was concentrated on coordination of national security systems with the aim to facilitate free movement of labour
- Development of internal market was seen as a key instrument for achieving RT goals
- Establishment of **European Social Fund** (low profile, lack of flexible programmes, replacement of national financing)

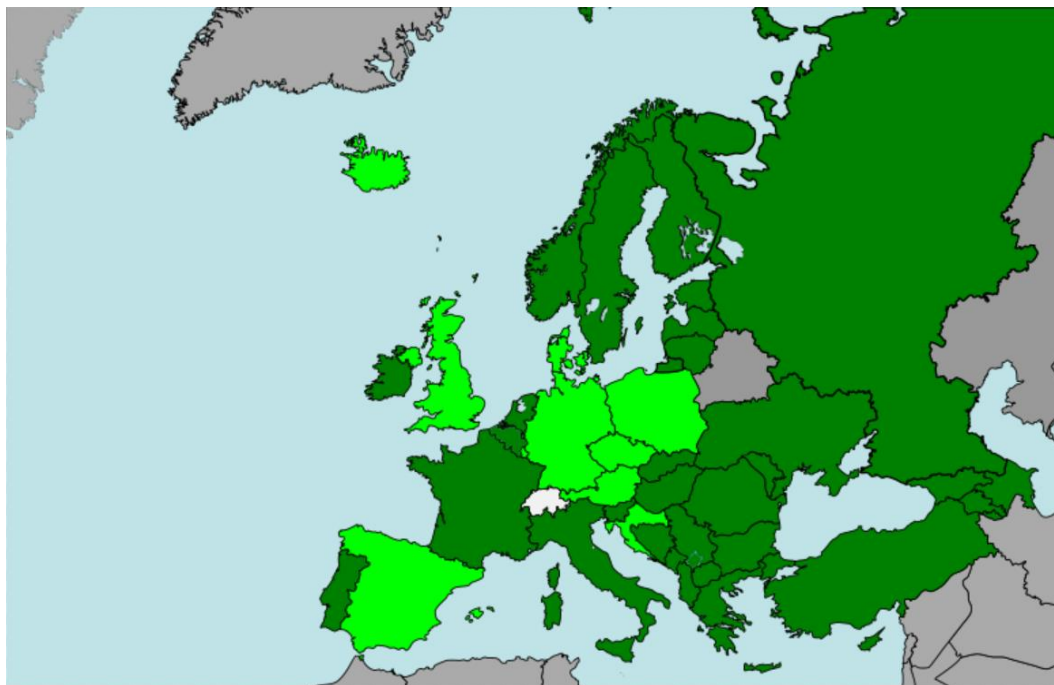
## ■ European Social Charter

- Adopted by **Council of Europe** in 1961 (**CoE is not EU institution**)
- International agreement about social and economic human rights (housing, health, education, employment, social protection, free movement of persons, non-discrimination)
- Starting point for future harmonization of national social policies in EEC countries

- The Charter sets out human rights and freedoms and establishes a supervisory mechanism guaranteeing their respect by the States parties
  - The improvement of living and working conditions
  - The right to freedom of movement
  - The right to employment with adequate remuneration
  - The right to social protection
  - The right to freedom and collective bargaining
  - The right to vocational training
  - The right of men and women to equal treatment
  - The right to information, consultation and worker participation
  - The right to health, protection and safety at the workplace
  - The protection of children and adolescents
  - The protection of elderly persons
  - Specific measures for disabled people

# Social Charter

- Members of the 1961 Charter in light green; members of the Revised Charter in dark green; non-member states of the Council of Europe in grey.
- The **European Social Charter** is a Council of Europe treaty which was opened for signature on October 18, 1961 and initially became effective on February 26, 1965, after West Germany had become the fifth of the 13 signing nations to ratify it. By 1991, 20 nations had ratified it.
- The Charter was revised in 1996. The Revised Charter came into force in 1999 and is gradually replacing the initial 1961 treaty.



# Evolution of EU social policy (2)

- **Social Dimension to Single Market (1985-92)**
  - Social cohesion is necessary for correcting negative impacts of increased competition and deregulation on the weaker and more vulnerable regions and sections of population
  - Fears of social dumping ⇒ minimum social standards for working conditions, health and safety
- **European Social Space**
  - Vision advocated by the president of EC Jacques Delors
  - Social dialogue: involvement of social partners in the EC decision-making process that affects the life of consumers and citizens, prominent role of EESC (European Economic and Social Committee)
  - Social Charter (Community Charter of the Fundamental Social Rights of Workers): non-binding declaration about social rights of workers (not accepted by UK – excessive regulation undermining competitiveness and employment)
  - Europe of the citizens: idea of bringing Community closer to the people
  - European Company Statute: unified set of rules, management and reporting provisions for safeguarding workers' rights

# Schengen Agreement

## ■ Schengen Area

- Founded in 1985: Benelux countries, France, Germany
- Elimination of border controls and removal of all control on people when they cross frontiers between Schengen countries
- Safeguard clause: reinstatement of controls in case of serious threat to public policy, public health or public security

## ■ Schengen group

- EU members except for UK, Ireland, Cyprus, blocking accession of Romania and Bulgaria
- Some non EU members (Iceland, Norway, Switzerland)

## ■ Provisions

- Schengen Information System (access to data files on persons, stolen or lost vehicles, bank notes, official documents, etc.)
- Common rules and procedures for checks at external borders
- Increased cooperation between customs authorities
- Common list of countries requiring visas

# Evolution of EU social policy (3)

- **Social Chapter of Maastricht Treaty (1985-92)**
  - Intention to incorporate the Social Charter into the MT
  - Strong opposition of UK Thatcher government (policy reversed under Blair administration)
  - Social Chapter added as a separate protocol
- **Amsterdam Treaty**
  - Idea of balancing price stability in EMU with an explicit priority for high level of employment
  - Legal basis for European Employment Strategy as a new major area for EU policy
  - Substantial parts of Social Charter incorporated in the Treaty
- **Nice Treaty**
  - European Social Agenda: promotion of employment, improvement of living and working conditions, appropriate level of social protection, dialogue with social partners, development of human resources, measures to combat exclusion
- **Lisbon Treaty**
  - Legally binding reference to the Social Charter (UK and Poland obtained opt-out)
  - Authority of Commission to support and complement activities of MS in selected social areas (working conditions, social security, collective actions, combating social exclusion, etc.)

# European Employment Strategy

## ■ Underlying idea

- Structural problems in European labour markets require collective action through more coordination and convergence of labour policies

## ■ Objectives

- Improving employability through active labour market policies (training for young and long-term unemployed, keep unemployed in touch with labour market, etc.)
- Encouraging adaptability of business and their employees (union-negotiated work reorganization)
- Strengthening policies for equal opportunities (between men and women, job opportunities for disabled)
- Developing entrepreneurship (deregulation and simplification of market access for small firms)

## ■ Europe 2020 quantitative targets related to EES

- 75 % of people aged 20-64 in work
- School dropouts rates below 10 %
- At least 40 % of 30-34 year-olds completing third-level education



# EU Social Model

## MATERNITY LEAVE

EU-27, 2011/12



WEEKS

70  
60  
50  
40  
30  
20  
10

Full-rate equivalent (FRE) paid Unpaid

BG UK IE SK EE CZ PL HU LT RO IT IV DK CY FI EL NL LU FR AT ES SI BE DE MT PT SE

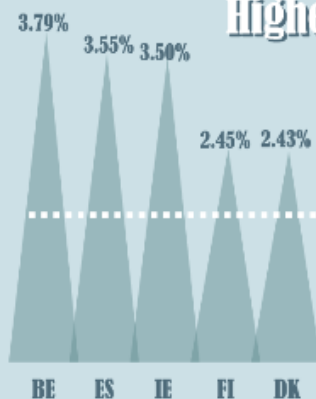
Sources: Eurostat, OECD, europa.eu  
September, 2013

## UNEMPLOYMENT BENEFITS AS % OF GDP

EU-27, 2010

Highest

Lowest



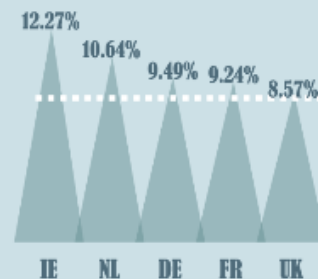
1.70%  
EU-27 AVERAGE

## SICKNESS/HEALTH CARE BENEFITS AS % OF GDP

EU-27, 2010

Highest

Lowest

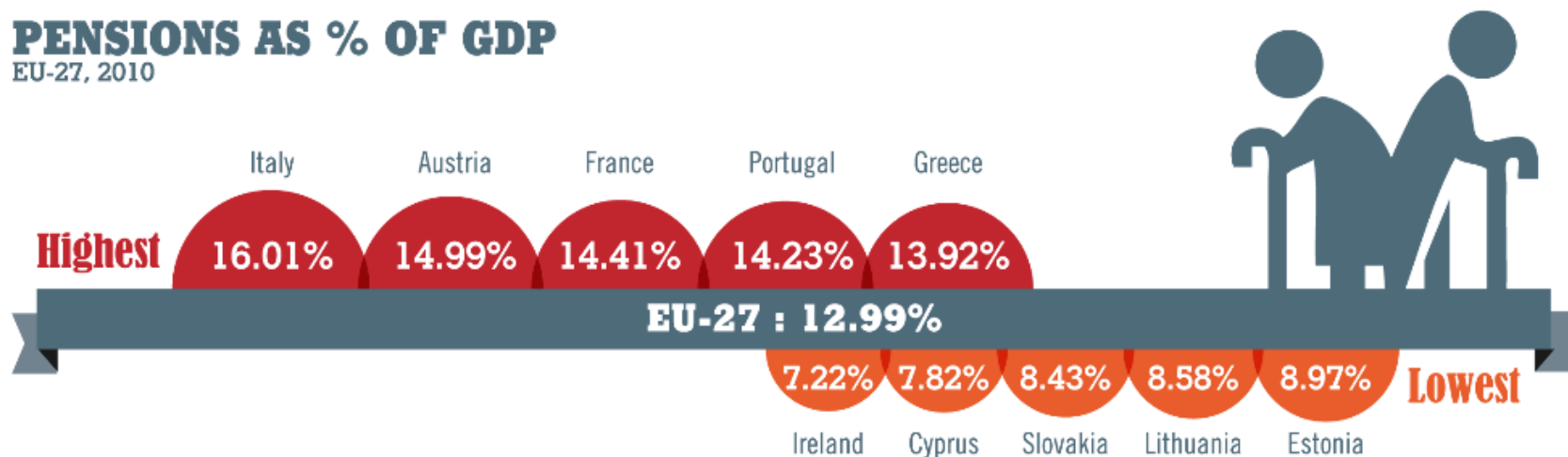


8.31%  
EU-27 AVERAGE

# EU Social Model

## PENSIONS AS % OF GDP

EU-27, 2010



## V. Challenges of Deeper Monetary Integration (from the labour market perspective)

# Challenges of deeper monetary integration

- **Labour mobility was identified as one of prerequisites of optimum currency area (Mundell criterion)**
  - Loss in competitiveness caused by excessive wage growth cannot be compensated through exchange rate devaluation
  - Without the exchange rate a country must undergo painful internal devaluation – restoration of competitiveness through depressed wage costs that unavoidably triggers recession
  - Benefits of labour mobility: reallocation of labour from high unemployment country to low unemployment country following asymmetric shock avoids the need for prices and wages to change
- **Complex nature of migration**
  - Economic incentives: wage gap, employment possibilities
  - Non-economic aspects: linguistic and cultural links, geographical proximity, family networks
  - Possible negative by-products: social tensions due to cultural differences, increased unemployment in certain jobs in receiving countries, pressures on welfare systems, impact on balance of payments due to remittances, increased regional disparities

**Thank you for your attention!**