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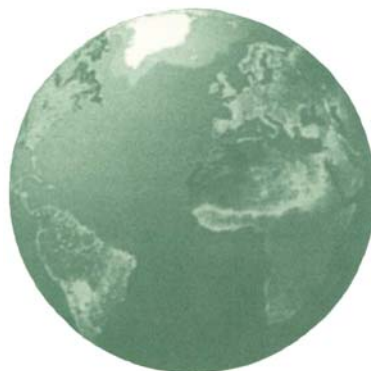
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**ANALYSIS OF THE SUCCESS AND FAILURE
IN THE LABOUR MARKETS OF SELECTED EU
MEMBER-STATES. MACROECONOMIC ASPECTS**



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SUMMARY

This article points out particular economic factors and policies which influence the level of employment/unemployment in selected Western and Eastern European EU member-countries. Their respective growth performance in the last decade is taken into consideration too. It sheds light on some of the myths related to labour-market success and failure by looking at the specific features present in the investigated countries. Through the analysis of indicators related to employment, unemployment and macroeconomy, we identify characteristic conditions which have been crucial for labour-market performance across Europe.

INTRODUCTION*

The European Union is the leading economic entity in the world: in terms of overall GDP, the EU 27 is ahead of the US, and much bigger than China and Japan. But the EU has not yet succeeded in setting the pace for growth, innovation and employment in a global comparison. Indeed, the opposite applies: the EU is more often perceived as a counter-reaction to globalization (Giddens 1999:124), and, worryingly, only as a slow and hesitant one. According to the Lisbon Strategy, the EU – facing the increasing competition from the USA and Asia (European Commission High Level Group 2004) – has agreed on the aim to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion (Lisbon European Council 2000). Although the European Union is lately experiencing relative economic stability as a result of an increasingly coherent monetary policy, there are still issues of great concern. Structural problems, lower economic growth and high levels of unemployment, especially after the 2004 enlargement, affect the EU's ability to cope with forthcoming challenges. European societies seem to feel fear for globalization and perceive it as a reason for higher unemployment, deindustrialization, sinking wages, *etc.* In an effort to cope, the implementation of the Lisbon Strategy was put forward. The EU thereby plans, *inter alia*, to achieve knowledge-based full employment, which will help improve its com-

petitiveness.¹ This is not a utopia: some of the EU member-states have been successful in the field of labour-market policy for a relatively long time. Conversely, some have not found their way to reach equilibrium yet, *i.e.* employment rates close to the level of full employment.

But what policies are sustainable in efforts to increase employment or even to achieve full employment? Both politicians and voters often see only one side of the problem and try to decrease the unemployment rate to a minimum level at any price in order to avoid social unrest. However, this short-sighted approach might have a negative impact on the economic condition of a country. First of all, there is no universal model of industrial or social relations which could assure the success of the labour market. Although, presented in this way, this statement may sound platitudinous, lessons are frequently drawn from a 'successful' member state and offered as a panacea for the EU 27. Second, the analysis shows that there is no correlation between the size of the country and its employment situation. It is frequently but wrongly assumed that smaller countries adjust better to changing conditions and act efficient, as they are more determinant in their actions (Auer 2000, Katzenstein 1985). Finally, high social-protection expenditures are no explanation for high inactivity rates, nor are they the cause of unemployment. To stress the point, a better labour-market situation is not dependent on the existence of low-level social protection.

The solution for reaching a stable equilibrium of relatively high employment in the labour area is the subtle combination of labour-market policy, macroeconomic policy and social dialogue. Each of the

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¹ European Employment Strategy, until 2010: Total employment rate – Employed persons aged 15-64 as a share of the total population of the same age group = 70 per cent; Employment rate – females – Employed women aged 15-64 as a share of the total female population of the same age group = 60 per cent; Total employment rate of older workers – Employed persons aged 55-64 as a share of the total population of the same age group = 50 per cent; regards the EU 15.

countries in the EU 25 has its characteristic features that push it towards success or failure. In order to present these characteristics specific states have been selected for analysis, and some categorization of their common features has been made. As a result we have 5 groups containing 12 countries:

- * Nordic countries (Denmark, Sweden),
- * Anglo-Saxon countries (Ireland and the UK),
- * Continental countries (France, Germany and the Netherlands),
- * South European countries (Portugal)

as representatives of different social models (Sapir 2006:376) in Europe and additionally

- * Central and Eastern European countries (the Czech Republic, the Slovak Republic, Hungary and Poland).

These selected countries offer a wide range of features for analysis. On the one hand, there is Denmark, a small and open economy that has relative advantage when the high share of part-time job or the high level of employment among young people is considered. On the other hand, there are representatives of Central and Eastern Europe, like Slovakia and Poland. Poland has not only a poor level of social protection and a low level of development in active labour-market measures, but is also facing the highest level of unemployment in the whole European Union. Similarly, Germany and France – known for their etatist stance – and the UK, more liberal, also perform differently, despite their common size.

1) LABOUR MARKET IN EUROPE. EMPLOYMENT, UNEMPLOYMENT AND INACTIVITY CHARACTERISTICS

1.1. Employment situation in general and by gender

The situation among the countries selected for analysis and within the EU 25 as a whole is diverse. When the EU 25 average is considered, there are two groups of countries. One, represented by Poland, Hungary, Slovakia and France, where employment rates are below the EU 25 average, and another with rates above the average, consisting of the Czech Republic, Denmark, Germany, Ireland, the Netherlands, Portugal, Sweden and the United Kingdom. For the time being, only four of the researched countries – Denmark, the Netherlands, Sweden and the United Kingdom – already fulfil the goals of the European Employment Strategy for 2010 with regards to total employment rates. Portugal and Ireland are close to the envisaged level of 70 per cent.

Employment rates are not static and it is crucial to examine them over a period of time. There are three countries where a downward tendency is visible: the Czech Republic, Slovakia and Poland. Poland has experienced the highest decrease of employment rate since 1998 among the selected member-states for analysis. Employment expanded the most in Ireland, by 7 percentage points. Between 1998 and 2005 rank orders have not changed significantly. In the first place there is Denmark, in the last, Poland (the latter has replaced Hungary). The greatest progress has been made by the Netherlands and Ireland. When the growth rate of this indicator is

considered, the first impression is that the Central Eastern European countries have the poorest results. (*Table 1*)

ment. In the other countries this indicator has fallen, most remarkably in Poland (7.6 percentage points), in Slovakia (3.2), in the

Table 1
Employment rates
(Employed persons aged 15–64 as a share of the total population of the same age group)

	1998	2005	Change	1998	2005	Change	1998	2005	Change
	Total			Women			Men		
EU 25	61.2	63.8	2.6	51.8	56.3	4.5	70.6	71.3	0.7
Czech Republic	67.3	64.8	-2.5	58.7	56.3	-2.4	76.0	73.3	-2.7
Denmark	75.1	75.9	0.8	70.2	71.9	1.7	79.9	79.8	-0.1
Germany	63.9	65.4	1.5	55.8	59.6	3.8	71.9	71.2	-0.7
Hungary	53.7	56.9	3.2	47.2	51.0	3.8	60.5	63.1	2.6
France	60.2	63.1	2.9	53.1	57.6	4.5	67.4	68.8	1.4
Ireland	60.6	67.6	7.0	49.0	58.3	9.3	72.1	76.9	4.8
Netherlands	70.2	73.2	3.0	60.1	66.4	6.3	80.2	79.9	-0.3
Poland	59.0	52.8	-6.2	51.7	46.8	-4.9	66.5	58.9	-7.6
Portugal	66.8	67.5	0.7	58.2	61.7	3.5	75.9	73.4	-2.5
Slovakia	60.6	57.7	-2.9	53.5	50.9	-2.6	67.8	64.6	-3.2
Sweden	70.3	72.5	2.2	67.9	70.4	2.5	72.8	74.4	1.6
United Kingdom	70.5	71.7	1.2	63.6	65.9	2.3	77.3	77.6	0.3

Source: Eurostat

The division into gender in two points of time, namely in 1998 and in 2005 reveals that Ireland has had the highest employment-growth rate among both women and men. Moreover, it corresponds with the highest growth rate of total employment. Data also show that many countries are trying to expand the access of women to the labour market, which is a result of following the early implemented guidelines for national employment policy (Action Programs against Unemployment 1993). All countries, except Poland, Slovakia and the Czech Republic, have increased the share of female labour force in the market. Polish women have the most difficult situation – they have experienced the highest decline in employment (4.9 percentage points). The leaders are Denmark, Sweden (around 70 per cent), the Netherlands and the UK. Ireland has made the biggest progress, while Hungary has been replaced by Poland in the last place. The male share of the labour market has lately gone through more dramatic changes. Apart from Ireland, France, Sweden, Hungary and the UK have all noticed an increase in male employ-

Czech Republic (2.7) and in Portugal (2.5).

1.2. Unemployment by country, age and gender

While in the EU 25 the unemployment rate has declined from 9.4 per cent in 1998 to 8.8 per cent in 2005, some of the individual member-states were not able to follow this broad trend. There has been a significant increase of unemployment in the Slovak Republic (3.7 percentage points) and Poland (7.5 percentage points). The negative tendency has also appeared in Germany, the Netherlands, the Czech Republic and Portugal. Ireland took a winning position in this aspect with its decrease of unemployment by 3.2 percentage points (*Table 2*). The rest of the countries, including both Nordic countries, France, the UK and Hungary, have also observed slight declines in unemployment rates. Changes within this indicator seem to point out the weakest parts of Europe, which are the South and

Table 2
Unemployment rates
(Unemployed persons aged 15–64 as a share of the total active population)

	1998	2005	Change	1998	2005	Change	1998	2005	Change
	Total			Women			Men		
EU 25	9.4	8.8	-0.6	11.2	9.9	-1.3	8.0	7.9	-0.1
Czech Republic	6.4	7.9	1.5	8.1	9.8	1.7	5.0	6.5	1.5
Denmark	4.9	4.8	-0.1	6.0	5.3	-0.7	3.9	4.4	0.5
Germany	8.8	9.5	0.7	11.1	10.3	-0.8	7.1	8.9	1.8
Hungary	8.4	7.2	-1.2	7.8	7.4	-0.4	9.0	7.0	-2.0
France	11.1	9.7	-1.4	12.9	10.8	-2.1	9.5	8.8	-0.7
Ireland	7.5	4.3	-3.2	7.3	4.0	-3.3	7.7	4.6	-3.1
Netherlands	3.8	4.7	0.9	5.0	5.1	0.1	3.0	4.4	1.4
Poland	10.2	17.7	7.5	12.2	19.1	6.9	8.5	16.6	8.1
Portugal	5.1	7.6	2.5	6.3	8.7	2.4	4.1	6.7	2.6
Slovakia	12.6	16.3	3.7	13.1	17.2	4.1	12.2	15.5	3.3
Sweden	8.2	7.8	-0.4	8.0	7.7	-0.3	8.4	7.9	-0.5
United Kingdom	6.1	4.7	-1.4	5.3	4.3	-1.0	6.8	5.1	-1.7

Source: Eurostat

the East. What is here worth highlighting however, is the fact that, although the official Swedish unemployment rate is around 8 per cent, the unofficial one is said to be even around 20 per cent² (Larson 2006:3).

Taking the unemployment rate itself into consideration, the highest is in Poland (over 17 per cent). This country has been suffering not only from the highest growth in unemployment rates but also from the highest amount of unemployed. Ireland,

² Although the official unemployment rate is now above 8 per cent, the employment rate (those employed as a share of the working age population) has not changed since the days of double-digit unemployment. The average employment rate over the past decade is 70.5 per cent. The share of 20–64 year olds choosing to drop out of the work force has been equally stable, averaging 18.5 per cent over the same period. It is not easy to determine the true level of unemployment in Sweden. Official accounts places it in the lower end of the EU, but one has to keep in mind that Sweden has a long history of the so-called active labour-market programs. It is highly contested whether or not these programs generate employment for their enrollers and whether or not they have any effect at all on the labour market itself. Estimates usually put total Swedish unemployment, including the so-called hidden unemployment, at somewhere between 15 and 20 per cent, about three times above the official unemployment figures. (...) about 20 to 25 per cent of the work force is unemployed and that most of them are “stashed away” in the statistics on long-term sick leave, in labour-market programs, or in early-retirement and similar programs (Larson 2006).

Denmark, the UK and the Netherlands have the lowest unemployment levels. All these countries – except the last – have lately managed to decrease their unemployment. From the Western European countries, in the worst position is France alongside Germany. In both countries the level of unemployment is near 10 per cent, while in Germany it is barely falling. In 1998, the Netherlands had the lowest unemployment rate and Slovakia the highest. After seven years, rank orders have changed significantly. There is Ireland, which has made great progress moving from 6th to 1st place. Countries like Denmark, the Netherlands, the UK and Portugal have changed their places within 2nd and 4th ranks. The rest have made modest changes. The last rank in 2005 belongs to Poland, preceded by Slovakia.

The analytical distinction made between males and females reflects once more that Poland has the worst labour-market conditions. Between 1998 and 2005 the female unemployment rate has risen about 7 percentage points and male unemployment 8 percentage points. Ireland and the Netherlands put in the best performance.³

³ Especially the Netherlands in 1998.

1.3. Inactivity rates vary across Europe

The next indicator that needs analyzing is inactivity rate. The inactivity rate is defined as the percentage of the population that is neither working nor seeking work, so it is not in the labour force (International Labour Office). This indicator shows what part of the workforce remains outside of the labour market and for which reasons. The limited availability of data obliges a focus on recent years for the sake of reliability.

Since 2000, the level of inactivity was the lowest in countries from the Nordic Group and the Netherlands. While Denmark seems to have an advantage regarding the lowest inactivity rate in its population as a whole and among women, the Netherlands is especially successful when the inactivity rate of men is considered, though with a negative trend of this rate. The greatest winner in this case is again Ireland. In last place is Hungary. There not only the inactivity rate for the whole population but also that separately measured for women and men belong to the highest among the investigated countries. (Figure 1)

MARKET

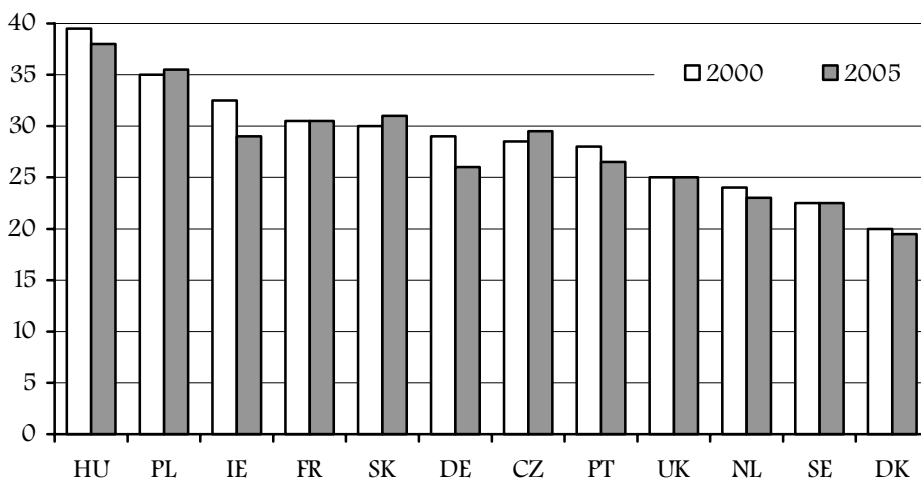
In the EU member-states there is an observable correlation between the performance of the economy and the performance of the labour market, and vice versa. Changes in employment do affect growth and this influence works as a sort of feedback also the other way round.

Crucially for the EU, changes in the age structure of the population can affect labour input. Specifically, if a population decline takes place in Europe, the labour force may stagnate or shrink. The outcome will be, other things unchanged, a decline in capital intensity, and a falling standard of living. However, if the inactivity rate is successfully reduced, income and capital per capita can stay stable as if there was population growth – at least for a while.

Finally, there is a linkage between various macroeconomic policies and the shape of the labour market. While monetary policy affects the demand side of the economy, wage bargaining mechanism as a tool of

2) THE ECONOMY IN THE MEDIUM RUN AND THE LABOUR

Figure 1
Inactive population aged 15–64 as a percentage of the total population
(fourth quarter data)



adjustment is addressing the supply side. Fiscal policy is of major importance too, because especially tax burden and tax rates may affect employment and output level.

In the following sections we will discuss those relations, bearing in mind both theory and practice.

2.1. Economic growth vs. employment

Growth theories attribute output growth mainly to the input of three factors:⁴

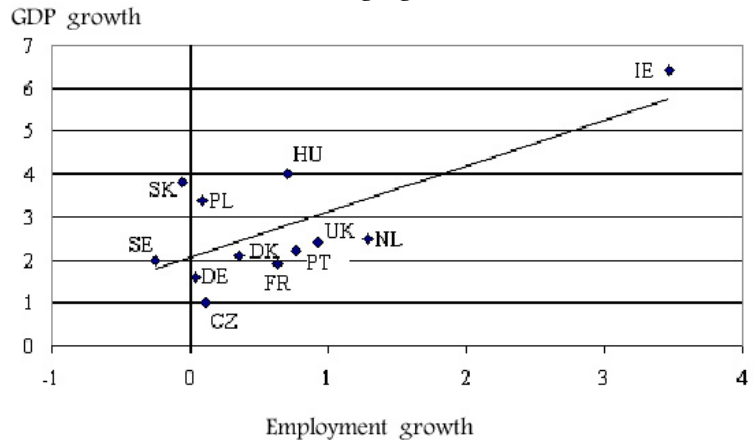
- * labour growth times the share of this input in income,
- * capital growth times the share of this input in income,
- * technical progress/growth of total factor productivity.⁵

In principle, the more people there are in the labour force, the more goods and services are provided. However, since WWII, employment growth has been losing importance as a source of productivity growth. The increasing role of innovation and improving qualifications among employees are lately the steering factors of economic growth. There is a growing need for human-capital development, which directly affects labour productivity. Labour productivity is the main factor of output growth, being at the same time the basis for the growth of society's welfare.

⁴ According to the growth accounting equation: $\Delta Y/Y = [(1-\alpha)\Delta N/N] + (\alpha\Delta K/K) + \Delta A/A$, where Y is the output, A is the level of technology/productivity, K is capital, N is labour, $(1-\alpha)$ and α are weights equal to labour's and capital's share of income.

⁵ The amount by which output would increase as a result of improvements in methods of production, with all inputs unchanged (Solow 1957:312–320).

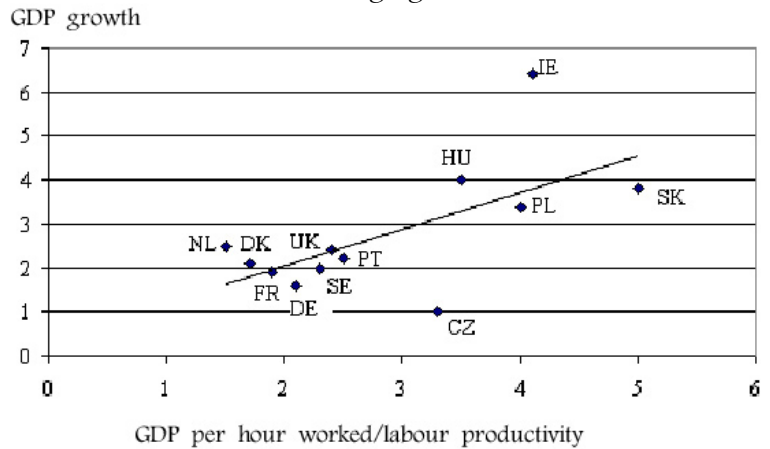
Figure 2
Relation between employment growth and GDP growth, 1990–2005
(annual average growth rates)*



* For employment-growth data from 1991–2005 (IE 1991–2005; DK, DE, FR, NL, SE 1992–2005; UK 1993–2005; CZ, SK 1995–2005; PL, HU 1996–2005; PT 1999–2005), GDP growth 1990–2004 (for HU and SK 1995–2004).

Source: Eurostat, DG ECFIN, European Economy, Spring 2004, OECD Productivity Database, September 2006.

Figure 3
Relation between GDP growth per hour worked/labour-productivity growth*, 1990–2005** and GDP growth (annual average growth rates)



* It grows as a result of technical progress and because of the accumulation of capital per worker.

** Productivity for CZ, HU and SK data from period 1995–2004, for PL 2000–2005. GDP growth 1990–2004 (for HU and SK 1995–2004).

Source: Eurostat, DG ECFIN, European Economy, Spring 2004, OECD Productivity Database, September 2006.

In Ireland the high average annual growth rate in GDP between 1990 and 2005 corresponded with both high productivity and employment growth (Figure 2 and 3). The Netherlands has also followed this approach, although not reaching such astonishing effects regarding GDP growth as Irish economy. Other countries repre-

sented far modest employment-growth rates, rather basing their growth on increasing productivity.⁶

When comparing the indicators from 2005, it can be noted that there are two patterns of economic growth. One has its roots in increasing productivity whilst the other is based on higher levels of job creation. According to the data, three sets of countries can roughly be identified:

- * predominantly employment-driven economic growth: Ireland;
- * predominantly productivity-driven economic growth: Germany, France, the Netherlands, Sweden, Portugal, Poland, the Czech Republic, Slovakia and Hungary;
- * between these two poles: Denmark and the UK have similar results for both factors, so they are moving towards economic growth both through productivity and employment growth.

Some countries have increased their levels of productivity per hour as a consequence of a reduction of average working time (CZ, FR, PL and SE). Moreover, in the case of the Czech Republic, labour-productivity growth is in general focused on industry, transport and public services (Podkaminer, Stehrer 2006:140).

Regarding economic growth, one more fact can be noticed. Countries from Eastern Europe have predominantly higher GDP-per-capita growth than the Western countries. This difference is estimated at 1.8 per cent to 2 per cent per year, will be maintained at least until 2015⁷ and is perceived as a prerequisite for catching-up with the EU 15.

⁶ Sweden between 1992 and 2005 and Slovakia between 1995 and 2005 have even noticed declines within annual unweighted average employment growth.

⁷ For more, see Maddison 2002, Podkaminer and Hunya 2005.

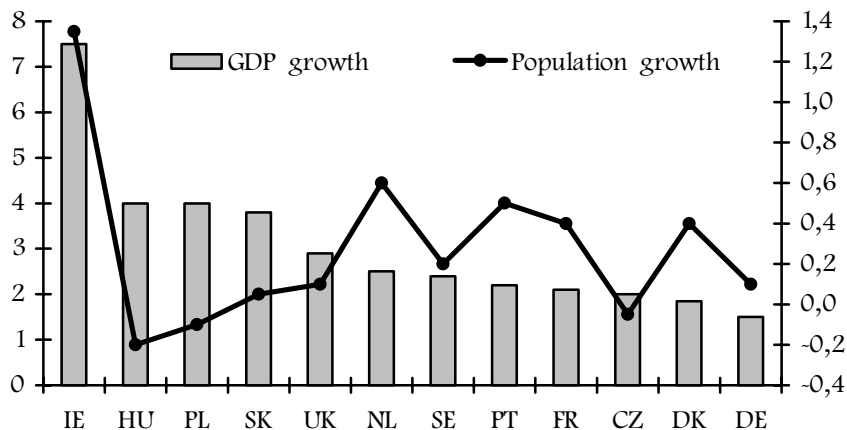
2.2. Population growth and the ageing-society phenomenon

Output growth depends on labour growth, on capital growth and on the speed of technical progress. In per-capita terms, in order to maintain the production function in equilibrium, income per capita and capital per capita have to be constant, meaning that both income and capital have to grow at the same rate as population.

In a steady-state, investment which is required to assure capital for new workers and to replace already used capital is equal to the savings provided by the economy. The level of capital per worker depends on investment, and the investment levels in turn depend on population growth and depreciation rate. If there is a population growth, the capital-per-head and output-per-head decrease, when investment is unchanged, though the aggregate output increases (Solow 1956:65–94).⁸ So far, the theory suggests that, other things equal, population growth will have a negative impact on per-capita income. Empirical observation, for example of the case of Germany's unification, adds weight to this supposition. In fact, the unification negatively affected output per capita (the most reliable indicator of economic wealth) in this country. However, the example of Ireland shows that population growth combined with an appropriate structure of population is fruitful. Some models suggest that to maximize the long-term per-capita growth there has to be a population growth of 1-2 per cent per year, a saving rate 2-4 per cent and a discount rate below 4 per cent (Simon 1977). Abstracting from other conditions, none of the countries, except Ireland, fulfils the proper requirement of population growth (*Figure 4*).

⁸ The linkage is as follows: $sy^* = sf(k^*) = (n+d)k$, where s is saving, sy is saving per capita, k is capital, n is a constant rate of population growth, d is depreciation.

Figure 4
GDP growth and population growth, 1995–2004
(annual average growth rates)



Note: Polish data for population growth is from 2005.

Source: Eurostat; EC; OECD: Productivity Database, September 2006.

Does this mean then, with respect to the theory, that in the shrinking societies the standard of living will rise? In principle, yes it will, but only when the share of the active population remains unchanged. However, in reality the answer is no, since almost the entire EU is an ageing society; until 2020 the share of population aged 65 and beyond is forecasted to increase in all analyzed countries. Only Ireland with the highest population-growth rates and total fertility rates in the EU stands out. The internal conditions found in Ireland are positive given its young society which in the future will be better prepared to carry the burden of pensions and extensive health care. Demographic projections indicate also that the population of Slovakia, Hungary and the Czech Republic will remain constant.

Therefore, in the case of almost all industrialized countries the issue of concern is not population decline itself but the age structure of society. An ageing society is already a problem, because with the growing numbers of older people, per-capita income tends to decrease. In other words, employment levels cannot be maintained because of too few people in labour force which ends up in a decline in output per capita. The situation in Sweden reflects the core of this problem. Until 2050 it will

increase its old-age dependency ratio⁹ from currently 29 per cent to 45 per cent and its total dependency ratio¹⁰ from 71 per cent to 85 per cent. Such changes will cause serious tensions within Swedish society, because of inequities that are now becoming more apparent. Moreover, beyond the growth aspect, there is a much more serious financial one: the ageing population causes significant financial implications (lower spending, higher taxes and

higher contributions).

When it comes to the pension burden, some of the countries have decided to tie benefits more closely to contributions. Slovakia and Hungary have decided to delegate a part of social security pensions into schemes funded from private resources. In France and Portugal pension benefits are increasingly dependent upon the length of contribution rather than merely upon the age of the individual. Additionally, France has increased the number of contribution years required to receive a full pension as a response to growing life expectancies. Both these countries offer their citizens to be retired earlier or later, however with changes in the size of pension. In the same field, Poland and Sweden have implemented a direct linkage between the level of pension benefit received and the contributions paid during working life as well as the life expectancy of the population. Germany conducts the indexation of its public-pension scheme which is dependent on the

⁹ Ratio of the population aged 65 and over to the population aged 20–64 (Eurostat, National projections, UN, World Population Prospects 1950–2050).

¹⁰ Ratio of the sum of the population aged less than 20 and the population aged more than 65 to the population aged 20–64 (Eurostat, National projections, UN, World Population Prospects 1950–2050).

relation between the number of employees and retirees (European Commission 2006).

Table 3
Total fertility rates

	2000	2005
Czech Republic	1.14	1.28
Denmark	1.77	1.80
Germany	1.38	1.36
Hungary	1.32	1.32
France	1.88	1.94
Ireland	1.90	1.99
Netherlands	1.72	1.73
Poland	1.34	1.24
Portugal	1.55	1.40
Slovakia	1.30	1.25
Sweden	1.54	1.77
United Kingdom	1.64	1.80

Source: OECD Country Statistical Profiles, Eurostat.

Another issue that has lately given rise to a lot of concern is low fertility rates. The worse is the situation in the labour-market, the lower is fertility rate. Such cause-effect linkages are the result of psychological fear, which derive from a feeling of insecurity. This linkage is marked in Slovakia, Poland and Portugal, but also in Germany. Changes in fertility rates are the result of the internal situation of a country but also of social mentalities. It is possible to stimulate the fertility rate through appropriate policy. The Swedish example shows that in the 1980s the fertility rate rose (from 1.6 in 1984 to 2.1 in 1991) as the result of social reforms. However, because of the economic recession at the beginning of 1990s it has declined again to 1.6 in 2001 (OECD 2003:23).

2.3. Monetary policy and employment, and the case of EMU

With their membership of the Economic and Monetary Union (EMU) all of the countries investigated have lost the flexibility of exchange rates, so they cannot use

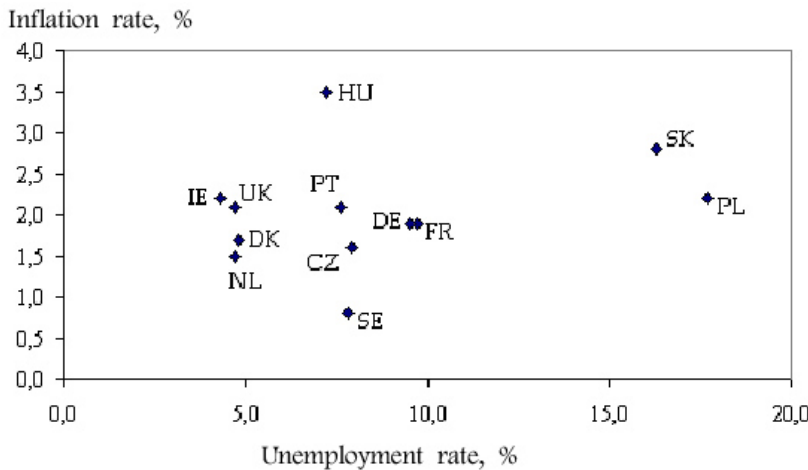
the currency devaluation to improve their competitiveness. As a result, other tools for adjustment have to be identified and applied in case of economic fluctuations. This, in turn, means that within the labour market more space for adjustments has to be provided (De Grauwe 2006:711–730). However, the question whether EMU has – or will have – a positive influence on the performance of the labour markets of its members still remains an open question. Among theoreticians both supporters and opponents of the statement that with EMU the employment situation of a country improves can be identified (Belke and Gros 2001:231–264). Some say that changes within flexible exchange rates are an obstacle for investment and employment development so that EMU implementation positively affects the economy and labour market (Mundell 1973). Others claim that the increase of price stability through EMU will be at the expense of greater volatility of output (Begg 2002:6).

The crucial factor is the feasibility of goals. Since the European Central Bank pursues a goal of price stability as its constitutional duty, only some particular countries – the non-members of EMU – can decide which goal should be given a greater priority: price stability or loss reduction in output and employment. Usually a tight monetary policy focused on price stability has to be adjusted by wage policy. Following this way of thinking, wage policy can lead to the recovery of labour markets (Auer 2000:42). According to *Figure 5*, it is notable that in 2005 almost all of the countries (except Hungary and Slovakia) decreased their inflation rates to or maintained them at a very low level (around 2%), so that the goal of price stability has generally been fulfilled. Theoretically, in the short run, all countries with low inflation have at the same time higher unemployment rates. Attempts to explain the real relation between inflation and employment in the EU by using the Phillips curve (the lower inflation, the higher unemployment in the short run) fail, as the case of Ireland, Denmark, the Netherlands and the UK

proves. These countries have found the “panacea” close to the ideal, combining relatively low unemployment rate with prices under control (Figure 5). The others lag far behind with respect to their unemployment rates. In Poland, for example,

ment tool, for example with reference to labour mobility or wage setting (CEC 2002:11). So far France and Germany are not able to provide enough flexibility within their labour markets whilst at the same time they are unable to cope well with economic fluctuations. A look at labour mobility in Germany indicates that workers are provided with high replacement ratios of unemployment benefits, which makes them reluctant to join the labour force. The result is odd, as the case of the German construction industry proves: here, in the 1990s wages were higher than the respective earnings in the UK or Portugal. This translated into the inflow of British and Portuguese workers into Germany in the 1900s, while the level of unemployment among German workers has in-

Figure 5
Relation between the rate of unemployment and inflation, 2005



Source: Eurostat

this is a result of incoherent goals: while the National Bank of Poland looks after low inflation and stable currency, making economic growth of lesser importance in its work, the fiscal policy focuses on high GDP and low unemployment. This suggests that the degree of and the ability for policy coordination is critical for the overall result.

The source of success in the countries investigated for labour-market performance is not EMU membership itself, as Table 4 shows. So what kinds of factors regarding macroeconomic policy affect the employment results of these countries?

Table 4
EMU membership and labour-market results

	EMU members	Non-members
Success	IE, NL, PT	DK, SE, UK
Failure	DE, FR	CZ, SK, HU, PL

As highlighted above, in the case of EMU membership the labour market starts to fulfil the important role of an adjust-

increased (Begg 2002:13).

When wage setting is considered, the nominal wage flexibility is a crucial substitute for monetary policy at the national level. However, in the national setting, the level where wage bargaining takes place is also important. Amongst the investigated countries, the process of wage setting has become more decentralized, with the sole exception of Portugal (Visser 2004:42–43). Wage bargaining remains at a sectoral level in Sweden, Denmark, the Netherlands, Germany and Slovakia. In the United Kingdom, the Czech Republic, Poland and Hungary it dominates the company level. France oscillates in between, however, lately it has focused more on the company level. Ireland has preserved a system of wage bargaining at the intersectoral level (Schulten 2005: Table 4). Research results indicate that patterns of decentralization will become common within the whole European Union because of the implemented reforms within the already existing wage-bargaining systems, and because of

the increasing pressure from the employers' side.

Wage flexibility can be helpful in the new member-states on their way to the euro too. A characteristic feature of the Central and Eastern European (CEE) countries is the fact that their nominal wages are rather inflexible. In the case of the Czech Republic, past experience of economic crises indicates that, apart from wage rigidity, the most serious problems for the Czech labour market are stickiness and the upward tendency of unit labour costs. In Poland and Slovakia, the rigidity of wages may be overcome because changes within unemployment are well followed by the changes in unit labour costs, despite the fact that the channels of adjustment are different. While the first country has linked its flexibility with productivity growth, the latter has focused more on inflation (Radziwiłł, Walewski 2006).

One additional problem related to wages, beyond the need for bargaining at the national level and a preference for flexibility, is the fact that the infrastructure and framework for social and macroeconomic dialogue has to be sufficiently developed to allow for wage changes in both directions (up and down) and to cope efficiently with asymmetric shocks. As it can be noticed, the countries with the most successful labour markets already have a long tradition of social dialogue and mutual cooperation between different levels of governance. Here the Netherlands stands out. Its Wassenaar Agreement (1982) as a social pact, and the Dutch Economic and Social Council (SER) and the Labour Foundation (STAR) as institutions, support dialogue and provide social partnership. In Ireland, the Programme for National Recovery (1987) supported by the Irish National Economic and Social Council and The Central Review Committee, plays a similar role.

2.4. Fiscal policy and taxation

In the period 1996–2005 only four of the 12 countries analyzed met the EMU Convergence Criteria for general government debt (the Czech Republic, Slovakia, Poland and the UK). In the same time span, eight other countries differentiated their levels of government debt. While for some of the countries having the debt higher than 60 per cent of GDP belongs to the past (DK, IE, SE, HU), for such countries like France and very lately Portugal and the Netherlands, it is a current issue of concern. Germany's deteriorating debt position is a growing problem too. The country has met the indebtedness criterion only in 1996 and 2001. Regarding the requirement of the government deficit, in the last 10 years only Sweden, Ireland and Denmark were able to stay below the level of 3 per cent of GDP.

Despite the restrictions imposed by the Growth and Stability Pact, a helpful – albeit limited – space for manoeuvre has been left to deal with asymmetric shocks (the Brussels–Frankfurt Consensus), stimulate growth and activity of labour markets' fiscal policy control. Labour-market revival or recession can be affected by properly implemented endogenous fiscal policy. The relation between fiscal policy and labour-market performance is explained by the aggregate demand structure where government expenditure is central. At the beginning of the 1990s, the Danish government used this instrument in the form of higher government spending and tax cuts to recover from recession. Through the higher consumer spending, aggregate demand has increased. To face the growing levels of consumption, business representatives had to increase the level of investment, which further stimulated employment-level increases. It is a common practice to conduct looser fiscal policy during recession in order to maintain more demand. However, it should not be forgotten

that in such situations an inflation threat exists. Through changes to the size or structure of expenditures, a particular country may stimulate its labour market. In this regard, good examples are offered by Denmark, Ireland and the UK, which seek to increase the productivity and employability of their labour force by increasing government expenditure on education. Public finance need to be reformed especially in the case of Poland where the unfavourable structure of expenditures and revenues is perceived as a restraining force for job creation and economic growth. Moreover, the result of its irrational pension system (for example, the KRUS¹¹ and other special pension systems differentiated for particular groups) is a burden in the form of 17 per cent of GDP spent on social protection – more than in the other EU countries (Dolgowska, Hishow 2006).

While fiscal spending is related to the demand side of the economy, taxation is related to the supply side and is of great importance too. In order to stimulate the economy, reforms in the following fields of taxation should be implemented:

- * decrease of high marginal tax rates on labour, production and investment,
- * reducing the level of distortions within the tax system.

However, one should bear in mind that lower taxes can become a danger: firstly, because of the threat of tax competition; secondly because the role of welfare systems might be endangered; finally because, despite the decreasing taxes, public goods and social protection have to be financed anyway. That is why a plausible shift of the tax burden¹² may occur, creating the risk of overtaxation of labour and undertaxation of capital (CEPII April 2001:16).

According to research based on general equilibrium models (CEPII April 2001), the cuts within particular taxes (social security

contributions, personal income tax and corporate tax), affect the economic situation of the country—what further affects labour-market performance—differently, depending on the size of the country, EMU membership and other factors. This is apparently because:

- * any cut within the above-mentioned personal income tax and corporate tax leads to higher output in a country conducting reforms; however, it is often forgotten that there exists a risk of fiscal deficit, so finally these cuts have to be replaced by tax rises or expenditures cuts;
- * tax cuts in a large country negatively affect the economy of partner countries;
- * the level of impact on neighbouring economies depends on the reforming country's membership of EMU;¹³
- * large countries are less sensitive to tax cuts, while the smaller/peripheral EU members might be seriously influenced by tax changes;
- * small countries are more eager to cut taxes than large countries;¹⁴
- * small countries gain more from a tax cut conducted alone than together with other countries.¹⁵

Therefore, in the case of tax cuts, it is not only the level of cut that is detrimental, but also its timing and the geographical situation of the country conducting particular reforms. Moreover, taking all these aspects into consideration, the reason why tax harmonization is an issue of such great concern is clear: it is obvious that, because large countries are relatively indifferent to tax cuts in other countries and because small countries gain less when they implement reforms at the same time as large countries, member-states have no real

¹¹ KRUS (pol. Kasa Rolniczego Ubezpieczenia Społecznego), a complex system of social security for farmers, including pension schemes financed in the biggest share from government resources.

¹² Labour force is the least mobile of tax bases.

¹³ If the reforming country is a member of EMU, the adjustment of the real exchange rate falls on prices (CEPII April 2001:7). In case of a non-member country, nominal exchange rates depreciate relative to non-reforming countries.

¹⁴ All Eastern European countries except Poland.

¹⁵ Especially with the big ones like France or Germany.

interest in harmonization. However, as examples of some big Eastern and Western European, not sufficiently open EU member-states like Poland as well as France show, not implementing taxation reforms causes serious implications for the economy as a whole, because of suffering from tax reforms conducted by other large countries (Germany).

To give some explanation but to retain the clear view of the topic, we will present countries of our focus in two dimensions of taxation reform: pro-labour and pro-investment tax cuts.

2.4.1. Pro-labour tax cuts

As we have already mentioned, one welcome solution within a favourable tax regime is the decline of marginal tax rates. This can push the economy towards pro-growth performance. If conducted, it will stimulate investment and entrepreneurship in society. This usually depends upon the prevailing marginal tax rates.

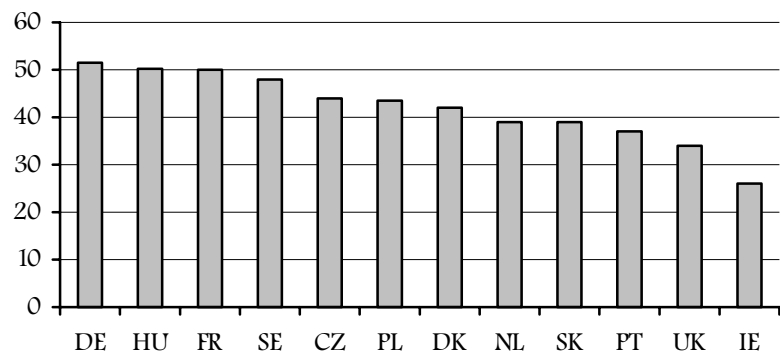
The OECD's Taxing Wages Report shows that countries like Ireland, the UK, Portugal and the Netherlands, which have employment rates higher than 67 per cent, have a relatively low total tax wedge,¹⁶ which makes their citizens eager to work (OECD 29.03.2006:Table 1.2). Yet, Sweden with a higher (but already decreased) total tax wedge of 47.9 per cent (*Figure 6*) brings this linkage between low tax wedges and high employment into doubt. At the beginning of the 1990s, Sweden conducted a tax reform. The result was a reduction of the marginal tax rates that is

¹⁶ TW: the difference between the employees' net pay and costs of being employed. Respectively: 25.7 per cent; 33.5 per cent; 36.2 per cent; 38.6 per cent.

perceived as a positive incentive to work, and may help to avoid the development of poverty traps.¹⁷ However, in this case, the high employment rate in the last 15 years is a result of overwhelmingly high employment in the public sector what corresponds with low input efficiency of this sector.¹⁸ The real exception here is Slovakia where, despite a relatively low total tax wedge, the level of unemployment remains very high.

Except in the case of Sweden, a decrease in total tax wedge in the period 2000–2004 was also noticeable in Denmark, Ireland, the Netherlands, Germany, Portugal and the Slovak Republic. The Dutch government agreed to lower the tax wedge by 1.1 per cent. In 2006, it reduced the level of social transfers (it restricted the length of time during which unemployment benefits can be drawn), which provided the opportunity to reduce labour-income tax. Slovakia has decreased its tax wedge significantly by 4.1 percentage points as a result of a cut in employers' social-security contributions. Hungary has implemented labour-cost reductions for

Figure 6
Current tax wedges in the EU
(percentage of labour costs)



Source: OECD, Economic Outlook No 77, June 2005.

¹⁷ It refers especially to unemployed or people whose main source of income are benefits. The higher the marginal tax rate is, the lower is the additional income from work.

¹⁸ Lower than the UK, DE, FR and DK (European Central Bank).

low-wage earners, which also caused a decline in total tax wedge.¹⁹

Reducing marginal taxation of labour is associated with smaller social-security contributions. Lowering the level of social-security contributions should be favourable for both employees (because the real wage inclines) and employers (because the real labour cost declines), so the result ought to be employment growth. Empirical evidence highlights the fact that, with the increase of production, firms need to create new production units by investing more in the short run (CEPII April 2001: 24), and these particular cuts support more labour-intensive technology. Thus the new production units are more labour-intensive than capital-intensive. That is why the use of the SSC cut as a tool to stimulate employment growth is more efficient than cuts in corporate-income tax.

Following these (often contested) considerations, most of the investigated countries have reduced their social-security contributions. This should have had a positive influence on the labour market. Indeed, this is the case for Ireland, the Netherlands and Sweden. However, the cuts there referred only to particular labour groups like low-wage earners and self-employed. In the last few years Germany has not only reduced its levels of social-security contribution, but also of personal-income tax and corporate tax. All these changes to its tax regime should give similar results for the German economy – increase of labour supply and labour demand, followed by employment rate and production growth – as they have for the other states. However, the increase in the employment rate between 1998 and 2005 was only 1.5 percentage point, what was mostly related to the increase in female employment at the expense of the decline in male employment. Additionally, the relatively large tax wedge (Figure 6) encourages people to avoid work. Similarly the “tax wedge obstacle” is perceptible in Hungary and France. What

else, then, explains Germany’s high unemployment rate beyond its tax wedge, which is the highest among the selected countries? One of the reasons for its poor economic and employment performance is the preservation of old structures: rigid labour law, high payroll load and, at the same time, low wage differentiation. However, the crucial factor in the case of Germany is its reunification. East Germany suffers from the weaknesses that characterized the GDR economy. East Germany’s adjustment difficulties are also the result of a too fast shift to West German conditions regarding wage, income level, social transfers and labour-market regulations (Walwei 2004), although ill-designed fiscal policy in the 1990s has also been an obstacle (just as in the case of Poland, since it is ill-suited to dealing with external shocks).

When it comes to France, is the poor performance regarding growth and employment the result of being a neighbour of Germany? If macro-econometric models assume that a large country like France is not sensitive to the tax cuts of small countries, is it experiencing asymmetric shocks as a result of an equivalent interdependence with Germany? The answer may lie in the fact that France is the biggest trade partner of Germany, both when exports and imports are considered²⁰ (Federal Statistical Office, Germany), and its bilateral openness rate as percentage of GDP towards Germany belongs to the highest.²¹ One could put this statement in doubt because while the bilateral openness rate for Germany towards France is 2.6 per cent of GDP, the same indicator towards the UK is 2.1 per cent of GDP. Why do difficulties and tax cuts in Germany affect more French than British economy? The answer has its roots in EMU membership: when there is a flexible exchange rate between the reforming country and its partners (as is the case for the UK), then the exchange

¹⁹ OECD, Progress in Responding to the 2005 Policy Priorities: Country Notes.

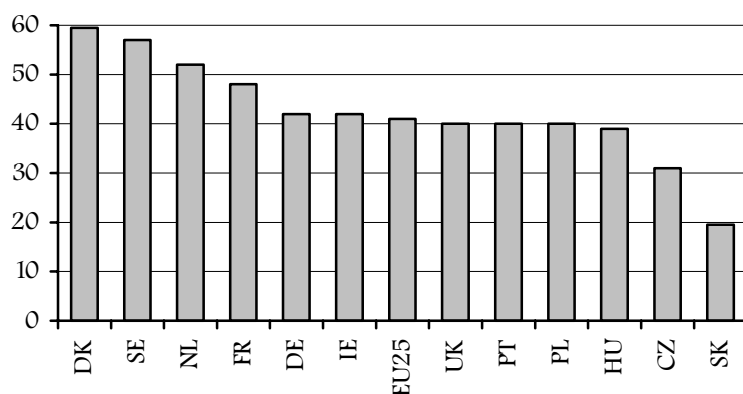
²⁰ In 2005, imports amounted to 54.627 bn euros and exports to 79.87 bn. euros.

²¹ Export of France to Germany as a percentage of France’s GDP is 3.1 per cent. Source: CHELEM-CEPII.

rate can be used as an automatic stabilizer of the economic situation and helps cope with asymmetric shocks from the outside.

Another tool that can be significant for pro-growth stimulation is personal income tax (PIT). The reduction of personal income tax is the most favourable of the conditions created for employees/workers, because it increases post-tax wage rate (CEPII April 2001:25) and, if conducted, stimulates demand and output growth. But in the real world there is no clear-cut linkage between the level of PIT itself and the labour-market performance of a country (Figure 7). However, analysis of PIT helps understand the high level of taxes in such countries like Denmark, Sweden and the Netherlands. The acceptance of the Nordic and the Dutch societies for high tax levels is a result of a conscious choice, since citizens, who value more public goods and services, prefer an economic system where the level of taxation and public services is higher (Tiebout 1956).

Figure 7
Top statutory personal-income tax rate in per cent, 2006



Source: EC Services, Eurostat, DG Taxud.

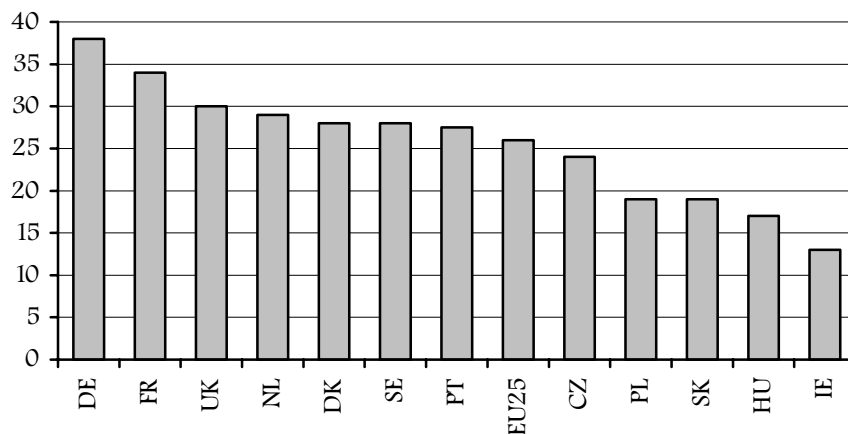
2.4.2. Pro-investment – the corporate income tax and taxation schemes

As already mentioned, growth within investment directly contributes to economic

growth. With the cut of corporate income tax (CIT) the profitability of companies increases, which is mirrored by an increase in production and employment.²² Countries with a high level of corporate tax are less attractive for foreign investors (Djurović-Todorović 2002:62). It is noticeable that countries like Ireland, Poland, the Czech Republic and Portugal, where the inward flow of foreign direct investment (FDI) stocks is higher than outward flows, have lower rates of corporate tax than the others (Figure 8). This would suggest that there has to be some kind of tax competition attracting FDI. EMU members have delegated their monetary policy to the ECB, so they are not able to use monetary policy as a tool of competition anymore. The role of this tool is partially replaced by competitive tax cuts and this is specially the case in Ireland and Portugal. The Czech Republic, Slovakia, Hungary and Poland are trying to give an incentive to their economies, through the profits flowing from FDI (output growth, employment growth). For example, Hungary has implemented changes in its tax-allowance scheme in the fields of research and development (R&D). Meanwhile, the Czech Republic, Slovakia and Hungary are more attractive to foreign investors than Poland. The reason lies in Poland's poor infrastructure and non-entrepreneur-friendly environment, complicated procedures and excessive bureaucracy. Better infrastructure, fiscal reform and proceeding privatization will all be helpful in Poland. However, it cannot be forgotten that the CEE countries are increasingly facing competition from Romania, Bulgaria, Turkey or China in terms of

²² However, employment growth takes place to a lesser extent than by cut in SSC because additional production units are more capital intensive than labour intensive (the result of higher level of investment). The differentiation between the SSC cut and CIT cut is a result of the assumption that labour and capital are not complementary.

Figure 8
Adjusted top statutory tax rate on corporate income in per cent,
2006



Source: EC Services, Eurostat, DG Taxud.

labour costs, corporate taxes, wage levels. This suggests that other factors have to be identified in order to attract investment (Podkaminer, Stehrer 2006:136).

Other countries, not as successful as countries with net FDI, are working to promote investment and stimulate aggregate demand. The Netherlands has reduced taxes for companies that decide to invest in R&D. Already at the beginning of 1990s, Sweden conducted a tax cut on investment aiming at higher capital stock, higher employment and more economic growth. Moreover, research results point out that cuts in capital income tax financed by an increase of the payroll tax will have a positive influence on the employment and growth rate (Michaelis, Birk 2004:3). Since 1983, Denmark has been decreasing the rate of corporate income tax; however the level of revenues from VAT and payroll tax remained the same. Denmark is pursuing an entrepreneur-friendly tax policy in order to stimulate employment and higher budget revenues.

The success of any particular country also has its roots in taxation schemes. The full-exemption scheme²³ and the partial-

credit scheme²⁴ allow corporations to avoid double taxation. In the countries with full-exemption schemes²⁵ the tax rate is a strong motivating factor for a company to change location of its investment, since the higher the difference between tax rates in the foreign country (lower CIT) and the country of origin (higher CIT) the more profits it will gain. Conversely, this incentive does not exist in the

partial-credit scheme implemented by Ireland and the UK. Here, the corporation does not take the CIT into consideration as long as its home country's CIT rates are higher than those of the countries where it has allocated its investments. This explains to a great extent the net FDI inflow position of the British and Irish towards the continental EU, where CIT levels are higher.²⁶

country from gains created by its daughter company allocated abroad.

²⁴ A mother company has to pay home tax rates anyway, so the profits made by its daughter company are taxed regarding the rules of the country of origin.

²⁵ Like France, Germany and the Netherlands.

²⁶ The second tax scheme has been adopted in Europe by the United Kingdom and Ireland, and by the United States and Japan elsewhere. Under such a scheme, the profit made by an affiliate is still taxed according to the rules in force in the given country. But when profits are repatriated, the mother firm is given a credit for taxes paid abroad, and has to pay taxes in the home country according to the domestic tax rules. Hence, under such a scheme, multinational firms are indifferent to tax differentials as long as the domestic rate is above the foreign one, since they will pay the home tax rate anyhow. They will only react to tax differentials when the domestic tax rate is below the foreign one, because they are not refunded for excess taxes paid abroad (only partial-credit schemes are applied). Under such a scheme, the effect of tax competition is radically different to what happens with the exemption scheme, since the sensitivity of FDI to tax rebates abroad disappears (CEPII April 2001:50).

²³ A mother company gains profits as long as the tax rates of the country where it has allocated its branch are lower than the tax rates in its home country. In this case the mother company is not obliged to pay corporate-income taxes in its home

3) ADDITIONAL FACTORS AFFECTING LABOUR-MARKET PERFORMANCE

3.1. Active labour-market measures

Another factor that can bring a country closer to the level of full employment is an active labour-market policy (ALMP). Although there is no relation between total

example, Portugal, despite the increase of ALMPs spending intensity, has not undergone such a large change in employment rate as Ireland has; by contrast, the latter has decreased its intensity of ALMPs spending.

The direct effect of the expansion of active labour-market programmes is to increase the number of those participating in them, which is followed by a decline in unemployment. Such gross effects might be reinforced by additional indirect effects, and this is the core of success. This success can be further supported by proper institutional framework, social dialogue or other factors. However, some doubt the effectiveness of these active labour-market programmes, claiming that they are more

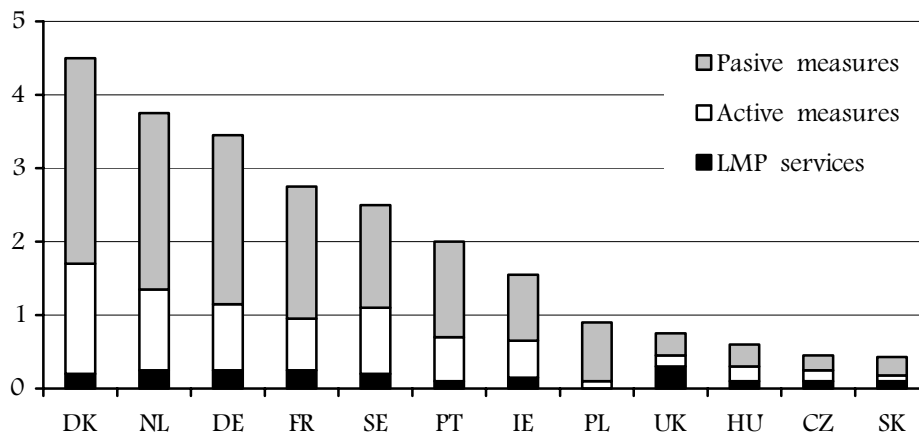
a source of employment than a bridge to employment for participants of these programmes. They can be perceived, along with long-term sick leave or early retirement, as roots of hidden unemployment (Karlsson 2006).

Research results point out that the labour-market success of a particular country can also depend on (Höcker 1998:191–214)

- * the structure of labour-market management,
- * the system of industrial relations,
- * the general administrative structures.

Countries that have decentralized their organization of labour administration perform better than those with centralized structures. Moreover, country specific industrial relations do influence the overall labour-market results too. For example, the representatives of Northern corporatism (Sweden, Denmark) or Anglo-Saxon plural-

Figure 9
Structure of public expenditures on LMP as a percentage of GDP, 2004

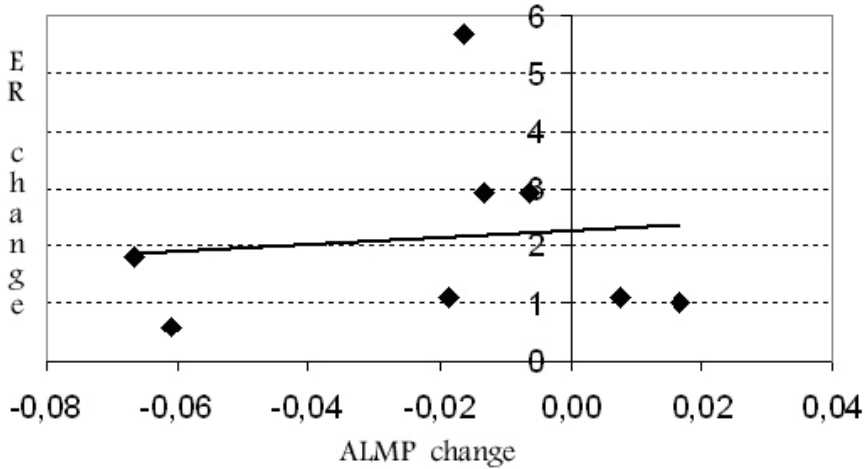


Source: Eurostat, OECD

labour-market policy's spending as a percentage of GDP and the level of unemployment as the examples of the UK or Germany show (Figure 9), the European Commission, basing its analysis on data from the period 1997–2002, claims that there is a linkage between ALMPs and employment rate increases (Employment in Europe 2004:Chapter 2). An increased intensity in ALMP expenditures²⁷ is said to be an explanation for employment growth rates of 10 per cent–20 per cent, however, data from the period 1998–2004 seem not to confirm this statement (Figure 10). For

²⁷ ALMP spending as a percentage of GDP divided by the unemployment rate.

Figure 10
Relation between changes in the intensity of ALMPs spending as a percentage of GDP and changes in employment rate (ER), 1998–2004



Note: there were no available data for PL, HU, SK and CZ.

Source: Eurostat, OECD

ism (Ireland, the UK) reach better results than the countries employing a Latin confrontation model (France). However, there are always exceptions. There is Portugal which belongs to the latter group but is not as much problematic. There is the Netherlands and Germany that, despite being numbered among the central social partnership models, have far different results in the labour market (Visser 2001). Finally, the Czech Republic, Slovakia, Hungary and Poland, as transition economies, still grapple with relics from the past in the form of inefficient industries and post-socialist mentality. In the case of Poland, the reason for poor performance is a negligence of the privatisation process, the structure of social security system and a large share of inefficient agriculture.

3.2. Reforms

Many of the implemented and ongoing reforms investigated here are crucial for better labour-market performance. In order to increase the employability of workers, more skills and education has to be provided together with flexibility. While these issues are key goals of the British labour-market

policy, they are secondary aims for Germany (Schmid, Roth 2006:8). This sheds light on the importance of goals and their meaning for labour-market performance. Denmark's success in increasing participation is remarkable. The Danish seek solutions in active labour market measures (on-the-job training, education) and these have indeed resulted in high employment. Similarly, the Netherlands has managed to limit long-term unemployment to 1.9 per cent through the Melkert jobs

offered to those who have been unemployed longer than 12 months and through the increase in flexible forms of employment (like part-time or fixed-term employment).

However, as the example of Ireland shows, there are always country-specific explanatory factors for success. Ireland, through the economic reforms conducted in the 1990s, limitation of bureaucracy and the opening of markets, has managed to transform itself from a country of mediocre performance, into one of the most dynamic economies in Europe. However, while the implemented reforms are the main factor of success, an important factor for the performance of this country are repatriants too. According to the Economic and Social Research Institute, Dublin, the return of repatriants means the return of high-qualified people who earn 15 per cent more than the Irishmen who have never worked abroad. Moreover, in 2005, 11 per cent of all Irish start-ups with the highest efficiency were founded by repatriants.

Against the backdrop of the EU diversity, what is the position of the Central and Eastern European countries? Even a cursory analysis shows that Poland, Slovakia, the Czech Republic and Hungary have to conduct proper reforms in order to

narrow the gap between their own and West European incomes. Governments of these countries have to be aware, however, that a long-term vision is needed to maintain sustained output growth. As the example of Poland shows, this country was able to implement a reform of its pension-system scheme, which allowed for decreasing the level of public expenditures on pensions (EC Forecast, 2004–2050). However, the positive results of this reform are constantly undermined by the existence of the KRUS pension system and the scheme of earlier retirement for miners.

4) CONCLUSIONS

Although it is impossible to give a single set of rules that could be helpful for improving the labour-market performance of a country, it is possible to offer observations and recommendations. First of all, predominantly, smaller countries deal better with labour-market problems and achieve better results than larger countries. Because they are more dependent on surroundings and external environment, they have to act in advance and to the higher extent. They do not have an innate advantage though. As the examples of the Netherlands, Ireland and Denmark show, it is possible to be small, dependent and have high employment rates at the same time. Secondly, the Central and Eastern European countries, and above all Poland and Slovakia are Europe's laggards. The gap between the new member-states and the EU 15 is going to deepen, if the new member-states do not conduct efficient reforms within their fiscal policies, taxation systems, education system, *etc.* For CEE it is also crucial to complete the privatization process and to implement entrepreneur-friendly environment, because low labour costs will soon lose importance as a decisive factor attracting foreign investors. The Central and Eastern European countries have to be

more decisive when changes are considered, stop preserve relics from the past and try to conduct the best practices of other countries regarding labour-market solutions. Active labour-market programs in Denmark or Melkert jobs for long-term unemployed in the Netherlands should be taken into consideration. At the same time, the countries should treat the best practices of the partners only as a benchmark. Instead of mindless copying the solutions of other countries, the particular country ought to adjust the solutions so that to adapt them to its internal conditions.

Furthermore, countries should focus themselves on decreasing the costs of labour by reducing the level of tax wedge, although tax-wedge decline alone is not a receipt for success. It has to be supported by increasing the activity and employment rate of the society to better cope with the ageing phenomenon. Flexibility of wages is also of great importance, especially that most of the EU member-countries already did or are committed to join EMU. The countries that cannot overcome this weakness will face serious problems with adjustment in case of appearance of asymmetric shocks and being at the same time EMU members. It also looks as if countries that are more obliged to assure their citizens a right to work than a right to income and where the state is more a supporter of employment and job creation than a provider of welfare – like in Denmark, Sweden, the UK and Ireland – deal better with difficulties in the labour market.

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