Cover sheet

For *JCMS Annual Review of the European Union*

Rising hopes in the European economy amidst global uncertainties

ISTVÁN BENCZES [a] and BALÁZS SZENT-IVÁNYI [b]

[a] Corvinus University of Budapest, [b] Aston University

Corresponding author: Balázs Szent-Iványi

Mailing address: Aston University, Aston Triangle B4 7ET, Birmingham, UK

Phone number:+44 121 204 3299

Email address: b.szent-ivanyi@aston.ac.uk

Rising hopes in the European economy amidst global uncertainties[1]

ISTVÁN BENCZES [a] and BALÁZS SZENT-IVÁNYI [b]
[a] Corvinus University of Budapest, [b] Aston University

Introduction

After years of recession and stagnation, the European economy picked up speed slightly in 2014, and 2015 saw strong signs of recovery, with growth reaching almost 2 per cent. Driven by increasing consumption and rising real incomes due to historically low inflation rates, as well as the expansion of exports supported by weak currencies, this recovery came at a time when storm clouds were brewing in the global economy. In 2015, the US increased the benchmark interest rate for the first time since the eruption of the economic and financial crisis in 2007-08. Chinese growth began transitioning to a new, lower normal, and key emerging markets, such as Brazil and Russia were in crisis, not to mention geopolitical risks like the huge inflow of refugees and migrants, and the conflict in the Middle East. These external conditions made Europe's improving performance even more noteworthy, but also question just how sustainable the European recovery can be.

The aim of this contribution is to analyse Europe's economic performance, focusing on the developments in 2015, but also placing them in a broader context. Just like our contribution to the previous year's *Annual Review* (Benczes and Szent-Iványi, 2015), this piece on the European economy focuses not only on the performance of the EU as a whole, but also on its Member States. It demonstrates which countries managed to outperform the others and which needed to heat up their engines. EU-wide generalizations along with data on average-performance can be misleading for such a heterogeneous region; yet, there is clearly evidence of some convergence among EU countries in terms of economic performance.

Europe's economic recovery has had a clear impact on its labour markets as well. The second half of this contribution provides a more detailed overview of labour market developments in Europe in the post-crisis era. After several years of labour market turmoil, unemployment is once again decreasing across the continent. Nevertheless, Europe is not out of the water yet, as unemployment is still higher and the labour force participation rate is still lower than immediately before the crisis. A special emphasis is put on investigating the impacts of the crisis of labour markets and how labour market policies have reacted.

Section I presents the global economic and political context, which is then followed by a discussion of the main economic indicators and Europe's performance in Section II. Section III focuses on monetary and fiscal policy developments, while Section IV provides an analysis of post-crisis labour market trends. The final section offers some brief conclusions.

I. The Global Economic and Political Context

[1] We are grateful to the editors, Nathaniel Copsey and Tim Haughton, for insightful and constructive comments

Global growth continued its decelerating trend in 2015, slowing to 3 per cent, which was well below the 5-6 per cent rates of the pre-crisis era. The collapse of the financial sector in 2007-2008 hit the developed economies unprecedentedly hard, while the developing world and the emerging markets proved to be more resilient to the negative effects of the crisis. By 2015, however, the situation changed dramatically. Slowly but steadily, advanced economies managed to increase their growth performance from 1.8 per cent in 2014 to 2 per cent in 2015, while emerging and developing economies suffered a huge drop in growth momentum by slowing from 4.5 per cent in 2014 to 3.7 per cent (see Table 1). 2015 proved to be the fifth consecutive year of slowing growth performance in less developed countries.

Table 1. The global economic context – Global and regional GDP growth rates

	2011	**2012**	**2013**	**2014**	**2015***
World	4.1	3.5	3.2	3.3	3.0
Advanced economies	1.7	1.1	1.1	1.8	2.0
EU	1.8	-0.5	0.2	1.4	1.9
USA	1.6	2.2	1.5	2.4	2.5
Japan	-0.5	1.7	1.6	-0.1	0.7
Emerging and developing economies	6.2	5.4	4.9	4.5	3.7
Brazil	3.9	1.8	2.7	0.1	-3.8
China	10.3	9.6	8.0	7.4	6.9
India	7.9	4.9	6.9	7.1	7.2
Russia	4.3	3.4	1.3	0.6	-3.7

Source: European Commission (2016, p. 179).

Note: * indicates forecast data.

The continued strong performance of the US, and the acceleration of growth in Japan and the EU all contributed to the relatively good performance of advanced economies. However, speculation that US monetary policy would be tightened, combined with an eventual interest rate rise by the Federal Reserve in December, as well as the accompanying reversal of capital flows, increasing volatility in financial markets, and the weakening of emerging market currencies all dampened the impact of the American economy on global growth.

The single most important factor for the relatively weak performance of developing and emerging economies was the continuous fall of commodity prices, which exerted highly negative impacts on most of these economies through several channels, leading to higher unemployment, lower tax revenues, increased government debt, intensified credit risk, rising current account deficits, and falling profitability and investment activities. Although the deterioration in the (net barter) terms of trade was somewhat counterbalanced by the sharp depreciation of most emerging market currencies, the loss of value of national currencies, in turn, could cause serious currency mismatches in both the financial and the non-financial sector's balance sheets, making emerging markets more susceptible to shocks.

The most vulnerable region of the year was perhaps Latin America – the region from where several contagious financial crises had emanated in the last three and a half decades. The EU

devoted significant efforts in the last fifteen years to strengthen its economic ties with the continent, mostly by ratifying trade agreements. The EU has indeed become the leading investor and the second most important trading partner for the region, with Brazil alone accounting for more than half of European investments and one-third of trade. The deceleration of economic growth can significantly undermine Europe's efforts to further expand economic relations with the region.

From 2012 onwards, the Chinese economy has been slowing down first to below 8 per cent, and by the end of 2015 to less than 7 per cent. This slowdown was not simply the consequence of the business cycle, but a deliberate effort of the Communist government to make the country more resilient to external shocks, and reorientate the economy towards a more consumption-driven model, with slower but more sustainable growth rates (IMF, 2015b). Such a policy shift raises serious concerns in the rest of the world, including the EU, as a deliberate shift in the main driver of Chinese growth can lead to a slowdown in international trade.[2]

As in previous years, global political tensions meant serious drags on economic prosperity; suffice to mention the acute conflict between Russia and Ukraine (and as a consequence Russia and the advanced economies) or the Syrian crisis, which has led to unprecedented flows of refugees to Europe.[3] The migration crisis has tested the solidarity among Member States, which was also undermined by the British threat of exit – all issues raising serious concerns about the future of the European economy and even the integration project itself.

As a consequence, despite good growth performance of the advanced economies along with the recovery in Europe, long-term growth prospects have not become any better. Due to serious macroeconomic imbalances such as record high public and private sector debt and structural deficiencies; particularly weak, undercapitalised financial markets; low investment activity; and negligible productivity increases (IMF, 2015a), the capacity of the global economy to weather a potential downturn looks bleak.

II. Europe's economic performance: growth, inflation and external balance

Despite the global tensions, the EU's economic recovery continued in 2015. After gaining growth momentum in 2014, growth further accelerated to 1.9 per cent in 2015, bringing Europe's business cycle in sync with the rest of the advanced world after several years. This relatively good growth performance was driven by a number of factors. Private consumption, subdued for years after the crisis, picked up significantly in 2015, surpassing its pre-crisis levels in real terms, fuelled in part by an increase in disposable incomes due to low oil prices. Investments and exports also grew significantly, reflecting renewed confidence in markets, although levels of investment in real terms still remain below their peak registered in 2007. The sharp fall in growth rates across the developing world is yet to have an impact on European exports, which were helped by the depreciation of the euro.

However, as in previous years, economic performance was highly uneven among Member States. The usual cleavages familiar from past years have remained: (1) countries outside of the eurozone grew somewhat faster than those inside (1.9 per cent and 1.6 per cent,

[2] China, the world's second largest economy, has become the second most significant trading partner of the EU after the US, while the EU is carving out the highest share in China's foreign trade.
[3] On the migration crisis see Börzel's and Monar's contributions to this volume.

respectively); (2) newer Member States achieved higher growth rates than older ones, with Malta (4.9 per cent), the Czech Republic (4.5 per cent), Poland (3.5 per cent), Romania (3.6 per cent), Slovakia (3.5 per cent), Latvia and Hungary (both 2.7 per cent) performing above the EU average (see Table 2). The faster growth of newer Member States may be evidence of strengthened convergence processes within the EU, severely halted by the crisis. [4] Among the older members, the performance of Ireland (6.9 per cent), Sweden (3.6 per cent) Spain (3.2 per cent), and the UK (2.3 per cent) are noteworthy. On the other end of the spectrum, Greece's economy stagnated (0 per cent) due to the uncertainties caused in the first half of the year around the extension of its bailout programme, and further austerity measures required after the extension.[5] Finland also stagnated, and three other countries (Austria, Italy, and Estonia) registered very low growth rates below one percent. The good news however, is that after several years of harsh contraction in quite a few Member States, 2015 proved to be the first post-crisis year that saw no country with a negative growth rate.

Among the large economies, Germany maintained its momentum from 2014, achieving 1.7 per cent in 2015; driven mostly by consumption, but private investment and a strong current account surplus also had a role. France finally seems to have left its close-to-stagnation state of the previous three years behind, although its growth rate of 1.1 per cent, fuelled by increased domestic consumption, is hardly spectacular. Italy is one of the countries in the EU which faced severe losses during and after the crisis. Nevertheless, 2015 proved to be a milestone for the Italian economy, as it managed to record a positive, though still moderate growth level of 0.8 per cent.

Table 2. Average EU growth rates (in per cent) and the best and worst performing Member States

	2011	**2012**	**2013**	**2014**	**2015***
EU average	1.7	-0.4	0.2	1.4	1.9
Standard deviation	2.9	2.4	2.2	1.7	1.6
Best performers	Poland (4.8) Latvia (5) Lithuania (6.1) Estonia (8.3)	Lithuania (3.8) Estonia (4.7) Latvia (4.8)	Luxembourg (4.5) Lithuania (3.5) Poland (3.5) Romania (3.5) Latvia (3.0) Malta (2.6)	Ireland (5.2) Luxembourg (4.1) Hungary (3.7) Malta (3.5) Poland (3.3)	Ireland (6.9) Malta (4.9) Luxembourg (4.7) Czech Rep. (4.5) Sweden (3.6) Romania (3.6) Poland (3.5) Slovakia (3.5)
Worst performers	Portugal (-1.8) Greece (-8.9)	Portugal (-3.3) Greece (-6.6)	Greece (-3.2) Cyprus (-5.9)	Croatia (-0.4) Finland (-0.4) Italy (-0.4) Cyprus (-2.5)	Finland (0) Greece (0)

[4] It is worth noting though that the newer Member States' growth record was rather diverse during the years of the crisis. Poland experienced a solid positive growth rate on the one hand, while Latvia suffered a cumulated loss of 25 per cent on the other hand.

[5] On the Greek experience see Featherstone's and Hodson's contribution to this volume.

Source: authors, based on European Commission (2016, p. 152).

Notes: the 'best performers' are the countries which showed rates at least one standard deviation higher than the EU average. 'Worst performers' are at least one standard deviation lower. * indicates forecast data.

Levels of inflation remained subdued across the EU in 2015, continuing the trend of moderation seen in previous years. The EU's average harmonized consumer price index stood at exactly 0 per cent in 2015; approaching slowly the danger zone of deflation. Low energy prices, falling import prices and the still present output gap in the euro area were, nevertheless, counterbalanced by more dynamic economic growth along with the pick-up of consumer demand which caused core inflation, calculated without energy and food price changes, to rise steadily. Looking at individual cases, it is striking that inflation remained weak even in countries which registered decent growth rates, such as Ireland (0.3 per cent), the UK (0.1 per cent), Poland (-0.6 per cent) or Spain (-0.5 per cent). As shown by these numbers, deflation was clearly a fact of life in many Member States in 2015, especially in Cyprus (-1.6 per cent) and Greece (-1.0 per cent), but a decrease in consumer price levels happened in a total of 11 economies. No country came close to the ECB's target rate of 2 per cent inflation, with Malta's 1.2 per cent being the highest (see Table 3).

Table 3. Average EU inflation rates (harmonized indices of consumer prices, in percentages) and countries with the lowest and highest values

	2011	2012	2013	2014	2015*
EU average	3.1	2.6	1.5	0.6	0.0
Standard deviation	1.1	0.9	1.0	0.7	0.6
High inflation	Romania (5.8) Estonia (5.1) UK (4.5) Latvia (4.2) Lithuania 4.1 Slovakia (4.1)	Hungary (5.7) Estonia (4.2) Poland (3.7) Slovakia (3.7) Czech Republic (3.5)	Estonia (3.2) Romania (3.2) Netherlands (2.6) UK (2.6)	Austria (1.5) UK (1.5) Romania (1.4)	Malta (1.2) Austria (0.8) Sweden (0.7) Belgium (0.6)
Low inflation or deflation	Czech Republic (2.1) Slovenia (2.1) Sweden (1.4) Ireland (1.2)	Greece (1.0) Sweden (0.9)	Bulgaria (0.4) Cyprus (0.4) Portugal (0.4) Sweden (0.4) Latvia (0.0) Greece (-0.9)	Slovakia (-0.1) Spain (-0.2) Portugal (-0.2) Cyprus (-0.3) Greece (-1.4) Bulgaria (-1.6)	Spain (-0.6) Poland (-0.7) Slovenia (-0.8) Bulgaria (-1.1) Greece (-1.1) Cyprus (-1.6)

Source: authors, based on European Commission (2016, p. 162).

Notes: countries with 'low inflation or deflation' are the ones which showed inflation rates at least one standard deviation below the EU average. 'High inflation' countries are at least one standard deviation higher. * indicates forecast data.

In terms of external balance, the trend of the previous years continued, with most creditor countries increasing their already huge current account surpluses even further (see Table 4).

The number of Member States with current account deficits decreased to nine. Germany, the EU's largest creditor economy, has seen its current account surplus reach yet another record following the crisis: 8.8 per cent of its GDP or € 267 billion. On the other hand, the UK continued to have the largest deficit, exacerbated by growing import demand. Strong economic growth and accelerating consumption contributed to the deficits both in the Czech Republic and Latvia. In some cases, current account surpluses can still be seen as a legacy of the crisis, with internal aggregate demand still being restricted, such as in case of Italy (see Benczes and Szent-Iványi, 2015). But improving export performance has increasingly been emerging as a key driver of improving balances in 2015, with countries like Ireland, Germany, Spain, France, Croatia, Hungary and the Czech Republic experiencing substantial improvement in their export performance.

Table 4. Average EU current account deficit (as percentages of GDP) and Member States with highest deficits and surpluses

	2011	**2012**	**2013**	**2014**	**2015***
EU average**	-0.9	0.1	1.4	1.5	1.8
Standard deviation	4.4	3.9	3.6	3.7	3.8
Highest current account surpluses	Netherlands (8.8) Luxembourg (6.2) Germany (6.2) Sweden (6) Denmark (5.7)	Netherlands (10.2) Germany (7.2) Sweden (6.5) Luxembourg (6.1) Denmark (5.6)	Netherlands (11) Denmark (7.2) Germany (6.7) Sweden (5.8) Luxembourg (5.7)	Netherlands (10.6) Germany (7.8) Slovenia (6.5) Denmark (6.3) Luxembourg (5.5) Sweden (5.4)	Netherlands (10.4) Germany (8.8) Denmark (7.1) Slovenia (6.9)
Highest current account deficits	Portugal (-5.5) Slovakia (-5.5) Greece (-10.4)	Greece (-4.3) Romania (-4.3) Cyprus (-5.1)	France (-2.6) Cyprus (-3.8) United Kingdom (-4.5)	Finland (-2.2) France (-2.3) Greece (-2.9) Cyprus (-3.8) United Kingdom (-5.1)	Latvia (-1.9) Czech Rep. (-2.4) Cyprus (-4.8) United Kingdom (-5.0)

Source: authors, based on European Commission (2016, p. 176).

Notes: countries with high current account deficits are ones which showed deficits at least one standard deviation below the EU average. Those with high surpluses are at least one standard deviation above. * indicates forecast data. **: un-weighted average of Member State current account balances.

Changes in competitiveness can be best approximated by the movements of the real effective exchange rate (REER), which captures the cost competitiveness of a country. The REER of the EU as a whole appreciated in both 2013 and 2014, but 2015 saw a substantial depreciation, driven mainly by a weakening single currency (see Table 5). As explained in last year's contribution (see Benczes and Szent-Iványi 2015, p. 172), Member State REER's can be more meaningful than that of the EU as a whole, which reflects the EU's changing competitiveness via its external trading partners. Most Member States saw substantial

improvements in their REERs; only the UK and the Baltic countries saw deterioration. The unusually strong loss of 8.3 per cent in the UK was triggered by the appreciation of the pound (at least until the end of 2015) and the growth of wages in a relatively tight labour market, although according to the *Guardian*,[6] wage growth was slowing throughout the year, and had dipped below 2 per cent in December 2015. Competitiveness rankings, especially the World Economic Forum's Global Competitiveness Index (World Economic Forum, 2015), show only minor changes compared to 2014, with some newer Member States improving their positions by five or more places. Besides the Czech Republic, Lithuania, Romania, Slovenia and Slovakia, Italy also managed to level up its competitiveness. The Greek deterioration in competitiveness finally came to a halt, but Greece still remained the least competitive country in the EU.

Table 5. Average real effective exchange rates, and highest appreciations and depreciations (unit labour costs relative to a group of industrialised countries, percentage change on preceding year)

	2011	2012	2013	2014	2015
EU	0.5	-4.9	7.9	3.2	-8.4
Un-weighted average of Member States	0.1	-2.0	1.6	0.0	-2.6
Standard deviation	2.7	2.8	2.9	2.8	3.2
Highest REER depreciation	Romania(-5.9) Ireland (-3.5) Poland (-2.6) Estonia (-2.5) Croatia (-2.5)	Spain (-6.6) Greece (-6.2) Ireland (-6.2) Croatia (-5.8) Portugal (-5.8) Romania (-5.2)	Greece (-6.3) Croatia (-2.6) Czech Rep. (-2.6) United Kingdom (-2.5) Hungary (-1.6)	Czech Rep. (-6.3) Hungary (-4.2) Sweden (-3.8) Croatia (-3.6) Cyprus (-3.2)	Ireland (-8.0) Greece (-6.5) Sweden (-5.7)
Highest REER appreciation	Czech Republic (2.9) Malta (3.7) Bulgaria (3.9) Sweden (7.5)	Latvia (0.9) Luxembourg (0.9) Bulgaria (1.4) Sweden (3.0) United Kingdom (4.1)	Estonia (5.2) Bulgaria (8.3)	Estonia (3.7) Latvia (4.0) Bulgaria (4.4) United Kingdom (5.3)	Latvia (0.9) Lithuania (1.1) Estonia (4.2) United Kingdom (8.3)

Source: authors, based on European Commission (2016, p. 167).

Notes: countries with high REER depreciations are the ones which showed depreciations at least one standard deviation below the EU average. Those with high appreciations are at least one standard deviation above the average. * indicates forecast data.

III. Economic policies in Europe

[6] 17 February 2016.

By and large monetary policy was very accommodative both inside and outside the eurozone, while fiscal policies were generally neutral. Some countries were rather active in downsizing their mountains of debt that they accumulated over the past few years, which has become one of the most serious challenges in the EU.

The official lending rate of European Central Bank (ECB) remained close to zero in 2015, just like in most of the countries outside the eurozone. Although the Fed increased its benchmark rate after seven years from 0.25 to 0.5 in December 2015, the ECB did not follow suit. The nine non-EMU Member States were also reluctant to copy the Fed and either stuck to the previous levels (such as the UK and the Czech Republic) or administered a further easing of their monetary policy. The most aggressive cuts in 2015 were implemented in Hungary, which lowered interest rates to a record low of 1.35 per cent down from 11.5 per cent in 2008 (see Table 6).

Table 6. Official central bank rates (in percentages) and long-term ratings

	Official central bank rate (lending rate)	**Date of last rate decision**	**Long-term ratings (Standard and Poor's)**
Bulgaria	0.01	February 2016	BBB-
Croatia	2.50	October 2015	BB
Czech Republic	0.05	November 2012	A+
Denmark	0.05	January 2015	AAA
Hungary	1.35	July 2015	BB+
Poland	1.50	March 2015	A-
Romania	1.75	May 2015	BBB-
Sweden	-0.35	July 2015	AAA
UK	0.50	March 2009	AA+
Eurozone	0.00	March 2016	various

Source: websites of central banks and Standard and Poor's.

With rates close to zero, European central banks were forced to turn to unconventional measures in the last few years to support their economies and to provide the European markets with liquidity. By and large, unconventional policy tools meant the purchase of assets. Besides the ECB's schemes such as the securities market programme, the outright monetary transactions programme, and the more recent public sector purchase programme, other European central banks have also been heavily involved in applying different unconventional measures. The Bank of England engaged in government bond purchases as early as January 2009, and launched its funding for lending scheme three years later. The scheme has been adopted by the Hungarian Central Bank as well. Hungary also set up a so-called 'bad bank' in 2015, which would have the responsibility of cleaning up other banks' balance sheets from toxic assets, especially mortgages. The Swedish and the Danish central banks decided to operate with negative deposit rates, while the Czech central bank started weakening the external value of the koruna more recently. On the other hand, the Bulgarian National Bank has become the target of harsh criticism for not being able to adequately supervise its financial system and for letting the country's fourth largest commercial bank to collapse.

Taking into account the very lax monetary policy of the ECB and the weakening of the euro, none of the non-EMU countries seemed to gain too much in relative terms (i.e. compared to countries paying with the euro) by sticking to their national currencies in the last few years. In fact, many of them, namely Bulgaria, Croatia, Hungary and Romania, instead continued to face low credit ratings (see Table 6) and highly volatile market rates. For these countries, adopting the euro would efficiently reduce the exposure of their currencies and economies to volatile and often hostile international markets.

While monetary policy continued to explore unchartered territories in order to boost aggregate demand, fiscal policy, in principle, can always be exploited by generating extra spending or lowering taxes – unless countries are strictly bound by legal restrictions to maintain sound fiscal positions, as they are in the EU. As for almost every single country embarked on large-scale spending programmes at the beginning of the global crisis EU states were forced to start putting public finances back into shape as early as 2011. Fiscal space was, therefore, considerably reduced in the last couple of years. As a consequence, the average EU headline deficit ratio dropped to the threshold of 3 per cent by 2014. In 2015 Member States managed to reduce the deficit ratio even further to 2.5 per cent (see Table 7).[7] This improvement was the consequence of the interplay of a multitude of factors, such as improved growth and reduced interest payments in particular.

Table 7. Average general government budget balances (in per cent of GDP) in the EU, and best/worst performers

	2011	2012	2013	2014	2015
Mean	-4.6	-3.8	-3.5	-3.0	-2.5
Standard deviation	3.3	2.6	3.3	2.5	1.7
Best performers	Germany (-0.9) Estonia (1.0) Luxembourg (0.3) Finland (-1.0) Sweden (-0.1)	Bulgaria (-0.5) Germany (0.1) Estonia (-0.3) Luxembourg (0.1) Sweden (-0.9)	Germany (0.1) Luxembourg (0.6) Sweden (-0.9)	Germany (0.3) Estonia (0.7)	Estonia (0.3) Germany (0.5)
Worst performers	Ireland (-12.6) Greece (-10.0) Spain (-9.4) Lithuania (-9.0)	Ireland (-8.0) Greece (-8.6) Spain (-10.3) UK (-8.3)	Greece (-12.2) Spain (-6.8) Slovenia (-14.6)	Bulgaria (-5.8) Croatia (-5.6) Cyprus (-8.9) Spain (-5.9) Portugal (-7.2) UK (-5.7)	Croatia (-4.2) Greece (-7.6) Portugal (-4.2) Spain (-4.8) UK (-4.2)

Source: authors, based on European Commission (2016, p. 169).

Notes: the 'best performers' are the countries which showed a budget position at least one standard deviation above the EU average. 'Worst performers' are at least one standard deviation below. * indicates forecast data.

[7] The eurozone average was even lower: 2.2 per cent.

The method of restoring fiscal discipline differed from country to country. In general, countries heavily relied on both revenue-based and expenditure-based consolidations (or a mix of these two approaches) throughout the years 2010 to 2015. The substantial increase in revenues can be partly explained by the relative improvement of economic conditions, as cyclically adjusted total revenues had also increased recently. The most dramatic revenue-side consolidation was adopted by Greece, relying mostly on the increase of direct taxes (by one-third). Belgium, Finland, Slovakia and Portugal were also very active in collecting more income in order to stabilise their public finances. Besides Greece, direct taxes such as taxes on income and wealth, were drastically increased in Finland, Portugal, Malta and France. Indirect taxes were increased especially in the Czech Republic, Spain, Italy and Slovenia. A third group of Member States, Bulgaria, Hungary, the Netherlands, Poland and Slovakia, initiated a consolidation in their welfare system by raising net social contributions.

Spending-side consolidations were pursued mostly by countries outside the EMU: Poland, Bulgaria, Romania and the UK. They were joined by the crisis-hit economies at the periphery and the Baltic States. These countries were all very active in downsizing welfare spending and public sector salaries, which are claimed to be the two politically most sensitive items (Alesina and Perotti, 1995). Ireland, Portugal and Spain also cut public investment, reducing its size by roughly one half in five years.

2015 was also a turning point in the post-crisis debt history of the EU. According to the European Commission's (2016) estimates, public debt-to-GDP ratios seemed to be finally showing a declining trend. The average debt ratio peaked at a record high of 88.6 per cent in 2014, but dropped to 87.2 per cent in 2015. In 2015, the new lows in both deficit and debt ratios came along with more countries successfully leaving the excessive deficit procedure (EDP). As a consequence of the financial and economic crisis, 24 Member States were put under EDP in 2010 and 2011. By 2015, their number had decreased to nine: the crisis-hit countries such as Spain, Portugal, Greece and Ireland, along with Slovenia, Cyprus and France from the eurozone, plus Croatia and the UK.

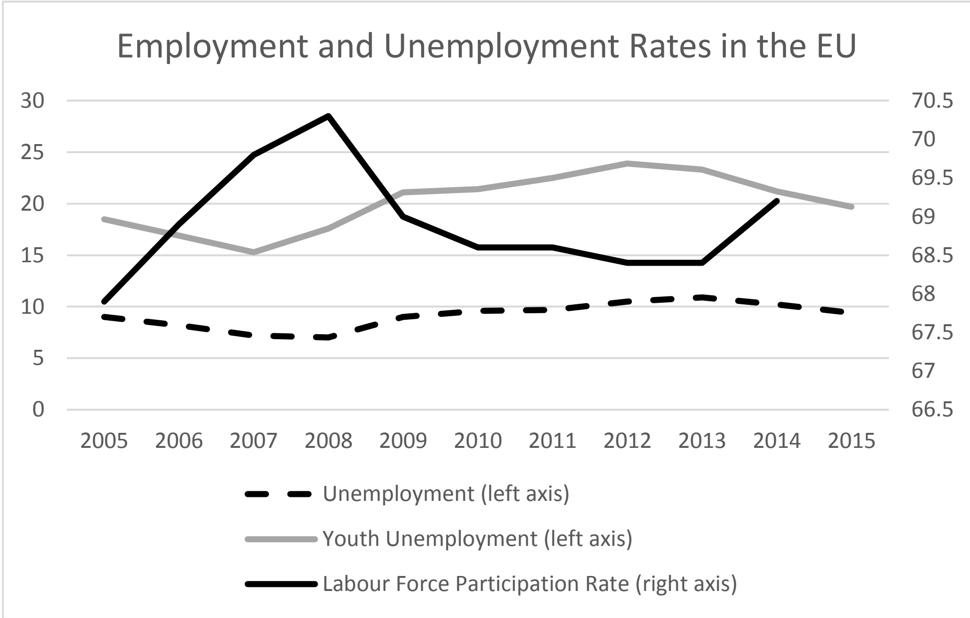
IV. Employment and Labour Market Policies after the Crisis

During the years before the crisis, European labour market activity had shown an ever-improving trend. Unemployment remained constantly below 10 per cent, reaching its lowest in 2008 at 7.0 per cent. The labour force participation rate steadily approached the magical level of 70 per cent, eventually reaching it in 2008. The crisis, however, witnessed millions of Europeans losing their jobs, with unemployment crawling up by a dramatic 3.9 percentage points by 2013. The labour force participation rate also decreased significantly, showing that many people chose to withdraw from the labour market altogether. Youth unemployment has also increased, with the large numbers of jobless providing increasing competition for new labour market entrants.

The economic crisis has clearly put significant pressures on governments, provoking the adoption of a number of reforms. Fortunately, economic recovery in 2014 and 2015 had a noticeable impact on labour market tendencies, as demonstrated by Figure 1. 2015 saw the average rate of unemployment return to single-digit numbers, at 9.5 per cent, but with significant heterogeneity across the EU. This section of the contribution provides an overview of the EU's post-crisis labour market recovery, first by analyzing the impacts of the crisis, followed by details on the impact of the recovery on labour markets, and finally government

policies. It argues that any optimism must be of the cautious variety. Both internal and external factors can make the currents trends not only highly vulnerable, but also easily reversible. Structural deficiencies are manifold. Most importantly, many EU countries are characterised by high levels of natural unemployment preventing the young and the chronically unemployed to enter the market.

Figure 1. Labour Force Participation and Unemployment Rates in the EU, 2005-2015 (percentages)



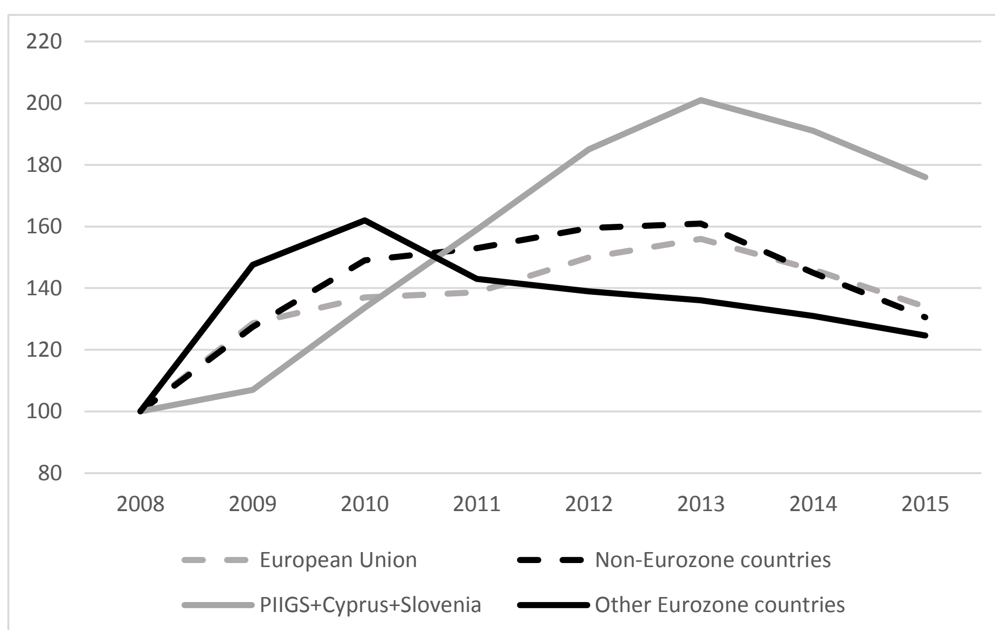
Source: authors, based on Eurostat data.

The crisis has had differential impacts on the labour markets of Member States. By clustering the countries into three different groups (the nine non-eurozone Member States, the 7 most heavily hit eurozone economies including Greece, Spain, Italy, Portugal, Ireland, Cyprus and Slovenia, and the remaining 12 EMU Member States), an interesting pattern emerges. For the EU as a whole, unemployment steadily increased between 2008 and 2013. However, the three groups showed very different developments. While the nine countries outside of the eurozone experienced a very similar pattern to that of the EU average, eurozone Member States had a very diverging and, in fact, puzzling experience. The two waves of the recession had very different impacts on the two clusters with EMU countries (see Figure 2). The seven countries which were most heavily hit by the crisis faced a much more moderate increase in unemployment (compared to their starting levels in 2008) in the first phase (i.e. the global stage) than their fellow EMU peers. Surprisingly, it was only in 2010 when these seven economies reached the average losses of the EU.[8] The other eurozone countries, on the other

[8] In 2008, the seven most heavily hit economies started at a relatively low level of 7 per cent, while the other 12 in the EMU had an average of 6.3 per cent. Non-EMU members recorded an average of 6.0 per cent in the same

hand, were hit massively by the first wave, elevating their unemployment rates on average by 60 per cent in just two years. In the second phase, however, the situation dramatically changed. The European debt crisis phase led to a doubling of unemployment in the seven distressed economies by 2013. In the other 12 eurozone countries, however, the second wave did not push unemployment up. In fact, the ratio steadily declined following the peak year of 2010. From 2013 onwards, unemployment improved in each of the three groups, though the seven heavily hit economies were still very far away from their pre-crisis levels in 2015. Most worryingly, with the exception of Cyprus, the share of long-term unemployed (those without a job for 12 months or more) was at least 50 per cent in these countries in 2015,[9] reflecting serious structural deficiencies.

Figure 2. Changes in unemployment, 2008=100 per cent



Source: authors, based on Eurostat data.

The analysis above reveals that the two phases of the double-dip recession had very different impacts on EU countries. While the collapse of the world economy in 2008 had a more pronounced impact on the core economies of the eurozone, the European debt crisis of 2010-12 had a toll in terms of jobs almost exclusively on countries in the periphery and left the core, by and large, intact. Countries without the single currency did not perform either better or worse in terms of job losses than the EU average, thus, adopting the common currency in

year. By 2010, the seven crisis hit economies had an unemployment rate of 11.5 per cent, while their EMU peers stood at 10.2 per cent. Non-EMU countries had quite a low level of 9.0 per cent.

[9] Greece had an abnormally high share of 73.7 per cent in 2015. Long-term unemployment is posing a real challenge for other countries as well such as Croatia (67.5 per cent), Slovakia (67.0 per cent), Bulgaria (63.0 per cent), Belgium (51.0 per cent) and Latvia (50.6 per cent).

itself was neither an amplifier of the crisis, nor a remedy to it, at least in terms of labour market outcomes.

From a country-by-country perspective, labour markets showed an even more profound heterogeneity (see Table 8). The most antinomic performance was produced by Germany. The country was severely hit by the first wave of the crisis, losing 5.6 per cent of its GDP in 2009, and found its unemployment rate peaking at 7.6 per cent in 2009. However, this rate was still much lower than what Germany suffered from just four years before that (11.2 per cent). The Hartz reforms, a series of tough labour market measures introduced between 2002 and 2005, seemed to pay off rather well for the former sick man of Europe.[10] In fact, the second wave of the crisis found an improving labour market with an unemployment rate of 5.2 per cent in 2013 when the EU average was at its highest. The rate dropped below 5 per cent in 2015.[11] While the German labour market can be seen as relatively dualistic with a high share of atypical employment (Eurostat, 2015), the flexibility of the labour market as a whole, including those in permanent positions, has increased substantially since the turn of the Millennium (Seeleib-Kaiser and Fleckenstein, 2007; Eichhorst and Marx, 2011). This performance is especially impressive when seen together with a continuously rising labour force participation rate.

Most other Member States, however, were not so lucky and have mostly seen 2-3 percentage points increases in their unemployment rates following the crisis. It is no surprise that the countries hit most severely by the crisis were also the ones which experienced the biggest hikes in their unemployment rates. Greece, Spain and Cyprus were the most dramatically affected countries. The change in unemployment between 2008 and 2013 (the years when EU averages were the lowest and the highest) was 19.7, 14.8 and 12.2 percentage points, respectively. Bulgaria (7.4 percentage points), Ireland (6.7), Croatia (8.7), Italy (5.4),[12] Lithuania (6.0), Portugal (7.6) and Slovenia (5.7) could not be proud of the degree of the deterioration either. These countries were all heavily impacted by both the global (2008-09) and the European (2011-12) phases of the crisis.

The Baltic countries on the other hand showed a rather different pattern from all other members. These small and markedly open economies were heavily beaten by the first wave of the great recession by experiencing a two-digit increase in the rate of unemployment in two years (between 2008 and 2010).[13] But from 2011 onwards, when the European public debt crisis took roots and pushed several economies into the second dip, they all managed to return to growth and make up for the job losses. Table 8 details the recent performance of Member States, and lists the best and worst performing countries. It is beyond the scope this contribution to speculate about either the causes or the consequences of such striking differences observed throughout the EU, but it reinforces analyses in the literature which argue that the eurozone is not an optimum currency area (see also Jager and Hafner 2013 or Handler 2013).

[10] Hartz IV bundled together all the previously segmented unemployment and social benefits and provided one single benefit package to those in need. Since beneficiaries had to experience a substantial cut in the net value of their welfare benefits, the reform plan made Germany the only country in the EU where labour earnings inequality actually increased in the last few decades (Koske et al., 2012).

[11] The only country which managed to replicate the German trick was Malta (6.9 in 2009, 6.4 in 2013 and 5.4 in 2015).

[12] Italy was an outlier in the sense that it experienced a further deterioration of 0.4 percentage points in 2014, too.

[13] In numbers: Estonia: 5.5, 16.7, Latvia: 7.7, 19.5, Lithuania: 5.8, 17.8 in 2008 and 2010, respectively.

Table 8. Average EU unemployment rates (in per cent of total labour force) and the best and worst performing Member States

	2011	2012	2013	2014	2015*
EU average	9.7	10.5	10.9	10.4	9.5
Standard deviation	4.3	5.2	5.6	5.3	5.0
Best performers	Austria (4.6) Luxembourg (4.8) Netherlands (5)	Austria (4.9) Luxembourg (5.1) Germany (5.4)	Germany (5.2) Austria (5.4)	Germany (5)	Germany (4.8)
Worst performers	Ireland (14.7) Lithuania (15.4) Latvia (16.2) Greece (17.9) Spain (21.4)	Portugal (15.8) Croatia (16) Greece (24.5) Spain (24.8)	Portugal (16.4) Croatia (17.3) Spain (26.1) Greece (27.5)	Cyprus (16.1) Croatia (17.3) Spain (24.5) Greece (26.5)	Cyprus (15.6) Croatia (16.2) Spain (22.3) Greece (25.1)

Source: author, based on European Commission (2016, p. 163).

Notes: the 'best performers' are the countries which showed unemployment rates at least one standard deviation below the EU average. 'Worst performers' are at least one standard deviation higher. * indicates forecast data.

In part at least, labour market structures and policies can be blamed for the severe impacts of the crisis in many countries. European labour markets have often been accused of heavy regulation and rigidity (Barbieri and Scherer, 2009). Countries like Portugal, Italy, Spain, France, Germany, the Netherlands and Belgium all have systems of strong employment protection, which includes regulations on severance payments, and a set of complex legal restrictions and administrative processes on dismissing workers. While providing a degree of job security for those employed, these systems have the tendency to generate high unemployment, as they increase the cost of hiring workers, which in turn makes firms more reluctant to hire (Blanchard *et al.*, 2014). In such situations, firms can be especially averse to hiring workers whose productivity can be difficult to assess, such as those of new entrants to the labour market, and those who have been unemployed for a long time. These problems have received much attention in the scholarly literature (see for example Saint-Paul, 1996), and European governments have been introducing measures to improve flexibility since the mid-1990s (Bentolila *et al.*, 2012a). The main thrust of reforms focused on making the usage of part time and fixed term contracts (Eichhorst and Marx, 2011). These 'atypical forms' of employment have gained popularity in many continental countries, and have resulted in the creation of dualised labour markets (Bentolila *et al.*, 2012a).

The spread of atypical employment however has only made European labour markets more flexible on the margins, and has not solved the underlying problem of rigidity and the high natural rate of unemployment (Blanchard and Tirole, 2003). It has also created new problems, ranging from social issues related to job insecurity and the inability of the atypically employed to access a number of services, all the way to negative impacts on productivity growth, with firms being reluctant to invest in training non-permanent employees. Promoting atypical employment was, however, seen by governments as politically attractive, as it did manage to create jobs in the short term, and allowed governments to avoid confrontation with trade unions, representing 'insider' workers in permanent contracts.

The boom of the pre-crisis years masked the unfavourable effects of dualised labour markets. The economic crisis underlined that dualisation might in fact be a dead end strategy for increasing labour market flexibility. With the onset of the crisis, firms were quick to lay off temporary workers, but full adaptation took a long time as laying off insiders was difficult and expensive. The example of Spain shows that the extremely high levels of unemployment can clearly be ascribed to the lax rules surrounding atypical contracts. Employees with such contracts have taken the brunt of layoffs after the crisis hit, but due to the low productivity of those in insider positions economic recovery was not made easier (Bentolila *et al.*, 2012b).

Reforming European labour market policies has thus become a priority after the crisis. The EU adopted the EU2020 growth strategy in 2012 with the goal of ensuring a 75 per cent labour force participation rate in the age group of 20 to 64 (European Commission, 2012a). No such ambitious target can be realistically achieved without bold structural reforms that enhance productivity, mobility and job quality. The goals of EU2020 were translated into policy proposals by the Employment Package (European Commission, 2012b), which aimed to help people find the way (back) to employment or find a higher quality and more rewarding job. It endorsed further internal flexibility and also called for active labour market policies. According to Ecorys and IZA (2012), active labour market measures such as (vocational) training or job-search assistance can be effective in delivering benefits both in the medium and in the long term. Fixed term contracts or employment incentives, however, provided rather mixed evidence. Employers can (mis)use the former to dismiss temporary workers; while the latter works only if targeted at specific groups and not the general employment.

Member States have made some efforts to translate these and other policy frameworks into practice. The remainder of this section focuses briefly on two issues in labour market policy, increasing overall labour market flexibility and youth unemployment.

Instead of supporting further dualisation, governments need to tackle the politically more sensitive issue of increasing the overall flexibility of their labour markets. The example of the Hartz reforms in Germany, as mentioned above, clearly shows that politically sensitive, large scale overhauls of labour market policies can be successful in the long run. Table 9 lists the main reforms that selected European governments have carried out since the start of the crisis, focusing on the countries which enacted the most significant reforms. The table shows that while many reforms have happened, a good number of them in fact entrench the dualistic nature of labour markets even further, for example by liberalizing the usage of fixed terms contracts even further, as in the cases of the Czech Republic, Italy and Portugal. There is also clear evidence of back tracking, with governments making firing and hiring in insider position even more difficult, as shown by reforms in Belgium, Ireland and Luxembourg. The two countries with the most anaemic labour markets, France and Italy, however, have finally initiated important reforms in 2015 and early 2016, it is nonetheless still too early to tell how these will play out.

Table 9. Labour market reforms in selected European countries, 2008-2015

Country	**Reforms**
Belgium	2015: Increase of the notice period for redundancy dismissals. 2012: Increase in the severance payment obligation.

Czech Republic	2014: Abolition of the minimum wage for young workers. 2013: Increase in the maximum duration of fixed-term contracts and reduction in the severance pay applicable in cases of redundancy dismissals of employees with one year of service. 2009: Reduction of limitations on overtime work per week. 2008: Elimination of the obligation for retraining or reassignment in cases of redundancy dismissals.
Finland	2015: Elimination of the requirement to notify a third party before dismissing an employee or group of employees
France	2015: Substantial amendment of labour market regulations, including the provisions dealing with large-scale collective redundancy processes
Germany	2016: Introduction of a minimum wage
Greece	2012: Decrease in the severance pay applicable in case of redundancy dismissals
Ireland	2014: End of a 60 per cent rebate for employers on severance payments and elimination of the requirement for third-party notification when terminating a redundant worker
Italy	2016: New Jobs Act, which simplifies redundancy rules and encourages out-of-court reconciliation, reducing the time and cost for resolving labour disputes. Also broadens the coverage of unemployment insurance. 2015: Relaxation of the conditions for using fixed-term contracts but reduction of their maximum duration to 36 months. 2010: Usage of fixed-term contracts permitted for permanent tasks. 2009: Increase in the notice period for redundancy dismissals.
Luxembourg	2010: Increase in severance payments applicable in redundancy dismissals
Poland	2011: Reduction in the maximum duration of fixed-term contracts
Portugal	2016: Introduction of priority rules for redundancy dismissals and new regulations for collective bargaining agreements. 2015: Reduction of the amount of severance pay per year of service and increase in the maximum cumulative duration of fixed-term contracts. 2014: Abolition of priority rules for redundancy dismissals. 2013: Increase in the maximum duration of fixed-term contracts and reduction in the severance pay applicable in cases of redundancy dismissals. 2012: Approval of new Labour Code: reduction in severance pay, reduction in overtime payment by 50 per cent, abolition of four paid public holidays, easier dismissal of workers 2010: Increase in both the notice period for redundancy dismissals and the maximum cumulative duration of fixed-term contracts.
Spain	2014: Reduction of the maximum cumulative duration of fixed-term contracts and increase in the minimum wage. 2013: Unlimited duration of fixed-term contracts allowed temporarily. 2011: Reduction of the notice period applicable in case of redundancy dismissals.

Source: World Bank (2016).

In terms of youth unemployment, one of the seven flagship initiatives of the EU2020 strategy was called ‘Youth on the move’ which aimed at strengthening the entry of young Europeans

to the labour market. As part of EU's Employment Package, the Youth Employment Package called for support in the form of continued education, traineeship or a new job after a four month waiting period for people under 25 who lost their job or left formal education. As the scheme is mostly financed by Member States, each country should adopt its own implementation plan. Until recently, the scheme only managed to make a real breakthrough in the wealthier countries with a strong welfare state system and an otherwise moderate youth unemployment rate such as Sweden, Finland or Austria (ILO, 2012). Youth unemployment remains worryingly high, especially in the Southern and some Eastern Member States. Youth unemployment for the EU as a whole peaked at 23.8 per cent in early 2013 and by the end of 2015 decreased to just below 20 per cent. The highest values were recorded last year in Greece (48.4 per cent), Spain (47.5 per cent) and Croatia (44.9 per cent). Germany, on the other hand, had hardly any problem: youth unemployment was at 7.1 per cent in 2015. The efficient German labour market, but also the country's relatively unique system of vocational training and apprenticeships seem to work well in absorbing young people.

Conclusions

The European economy continued its recovery in 2015, posting its highest growth rate since 2007, fed by strengthening domestic consumption, a weakening single currency and improving export competitiveness. Europe's decent growth performance was translated into decreasing unemployment, improving government budget balances, and reduction in public debt, all indicating that Europe has left behind the double-dip crisis. For the first time since the eruption of the financial and economic crisis, none of the EU28 economies recorded negative growth. The economic performance of the EU was less heterogeneous in 2015 than in previous years.

Nevertheless, Europe's recovery is still obviously fragile due to both internal and external factors. The global economic and political environment is full of uncertainties and ambiguities. Every corner of the world might hold something in store. The transition to slower growth in China, the tightening monetary conditions in the US, the slowing of economic activity in emerging markets, and conflicts in the Middle East can expose the European recovery to unwanted shocks in the near future. In such a hectic external environment, one of the crucial questions is whether the EU can respond collectively. The external shocks might pose rather different challenges for Member States. While small open European economies are strongly dependent on the large ones, especially Germany, and to a lesser extent France, the UK or even the Netherlands, the economic performance of the big ones is directly linked to overseas markets. Anything that happens in the USA or China can have a dramatic effect on Germany for instance. But events in Russia, Turkey, Korea, Japan or the United Arab Emirates, all in the top 20 trading partners of Germany, will have impacts. And the EU itself is not without internal troubles either. Greece is still at zero growth which pushes the country further away from the EU average. But Finland, Austria or Italy have nothing to celebrate yet either. Additionally, the unusually low rate of inflation, and indeed deflation in some countries, the still huge debt burdens, the threat of recovery without jobs etc. are all major problems, with monetary and fiscal policy not having much real capacity and ability to impact any of these.

The contribution has also explored European labour markets and employment policies after the crisis. More than eight years after the financial and economic crisis, Europe is yet to return to pre-crisis levels of labour market performance. While European labour markets have

reacted well to the economic upswing, unemployment is still above the level of the pre-crisis era. Countries which were hit by the crisis the most are still much behind their peers on the road to recovery in terms of employment. Most worryingly, it is not only short-term unemployment that seems to pose a burden on the PIIGS (along with Slovenia), but also long-term and structural unemployment. It seems that the inflexible and dualistic nature of European labour markets has made the impacts of the crisis unexpectedly painful in many countries, Germany being probably the only exception to this trend. Whether other countries should (or can) follow the German example is rather uncertain at this point, since Germany, the main market for most of the European countries, has become the most competitive economy in Europe, accumulating the largest surplus in its current account. Although the PIIGS countries did experience a recovery in their trade balance (with the exception of Spain), this happened mostly at the cost of reduced imports, while export capacity was barely strengthened. European countries should not be spared from much-needed structural reforms, yet, it is quite often the case that such reforms do put an extra burden on societies in the short run, which is quite unacceptable for many coming so soon after the sufferings of the crisis years.

References

Alesina, A. and Perotti, R. (1995) 'The political economy of budget deficits'. *IMF Staff Papers*, Vol. 42, pp. 1-31.

Barbieri, P. and Scherer, S. (2009) 'Labour Market Flexibilization and its Consequences in Italy'. *Europan Sociological Review*, Vol. 25, No. 6, pp. 677-692.

Blanchard, O. J., Jaumotte, F. and Loungani, P. (2014) 'Labor market policies and IMF advice in advanced economies during the Great Recession'. *IZA Journal of Labor Policy,* Vol. 3, No. 2.

Blanchard, O. J. and Tirole, J. (2003) 'Contours of employment protection reform'. *MIT Department of Economics Working Paper,* 03-35.

Bentolila, S., Dolado, J. and Jimeno, J. (2012a) 'Reforming an insider-outsider labor market: the Spanish experience'. *IZA Journal of European Labor Studies,* Vol. 1, No. 4.

Bentolila S., Cahuc P., Dolado, J. and Le Barbanchon (2012b) 'Two-Tier Labour Markets in the Great Recession: France *Versus* Spain'. *The Economic Journal*, Vol. 122, No. 562, pp. F155-F187.

Benczes, I. and Szent-Iványi, B. (2015) 'The European Economy in 2014: Fragile Recovery and Convergence'. *JCMS*, Vol. 53, No. s1, pp. 162-180.

Ecorys and IZA (2012) *Analysis of costs and benefits of active compared to passive measures*. Final report. END/NZ EI22101, Rotterdam: Ecorys

Eichhorst, W. and Marx, P. (2011) 'Reforming German labour market institutions: A dual path to flexibility'. *Journal of European Social Policy,* Vol. 21, No. 1, pp. 73-87.

European Commission (2012a) *Europe 2020: Europe's growth strategy.* (Brussels: European Commission).

European Commission (2012b) *Towards a job-rich recovery.* (Brussels: European Commission).

European Commission (2012c) *Proposal for a Council Recommendation on Establishing a Youth Guarantee.* Commission Staff Working Document SWD(2012) 409 final. (Brussels: European Commission).

European Commission (2016) *European Economic Forecast Winter 2016.* (Brussels: European Commission).

Eurostat (2015) 'Employment statistics'. Available at http://ec.europa.eu/eurostat/statistics-explained/index.php/Employment_statistics.

Handler, H. (2013) 'The Eurozone: Piecemeal Approach to an Optimum Currency Area'. *WIFO Working Paper*, 446.

ILO (2012) *Eurozone job crisis: Trends and policy responses*. (Geneva: International Labour Organization).

IMF (2015a) *World Economic Outlook. Adjusting to Lower Commodity Prices*. (Washington D.C.: IMF).

IMF (2015b) 'People's Republic of China. 2015 Article IV consultation'. *IMF Country Report,* 15/234.

Jager, J. and Hafner, K. A. (2013) 'The Optimum Currency Area Theory and the EMU'. *Intereconomics*, Vol. 48, No. 5, pp. 315-322.

Koske, I., Fournier, J. and Wanner, I. (2012) 'Less Income Inequality and More Growth – Are They Compatible? Part 2. The Distribution of Labour Income', *OECD Economics Department Working Papers*, No. 925.

Saint-Paul, G. 1996. *Dual labor markets*. (Cambridge, MA: MIT Press)

Seeleib-Kaiser, M. and Fleckenstein, T. (2007) 'Discourse, Learning and Welfare State Change: The Case of German Labour Market Reforms'. *Social Policy & Administration,* Vol. 41, pp. 427–448.

World Bank (2016) *Doing Business. Business Reforms for Labor Market Regulation*. Available at <<http://www.doingbusiness.org/reforms/overview/topic/labor-market-regulation>>

World Economic Forum (2015) *The Global Competitiveness Report 2015-2016*. (Geneva: World Economic Forum).