Jobs and Growth: Supporting the European Recovery

M. Schindler, H. Berger, B. B. Bakker, and A. Spilimbergo (eds.)
Unemployment is too high

Unemployment
(Percent of labor force)

Youth Unemployment
(Percent of labor force below age 25)

Sources: Eurostat, Haver Analytics, IMF World Economic Outlook and Fund staff calculations.

Sources: Eurostat, Haver Analytics and Fund staff calculations for latest monthly observation (November 2013).
Outlook is for modest growth

**Real GDP Growth**
(Percent change)

Sources: IMF World Economic Outlook and Fund staff calculations.
Deleveraging

Indebtedness in the Euro Area
(by country and sector, in sphere if debt higher than 60th percentile)

Sources: ECB, Haver Analytics, and IMF Staff estimates.
Reform gaps

**Product Market Regulation**
(Index scale of 0-6 from least to most restrictive; 2008) 1/

- Overall PMR
- Professional services
- Administrative burden on start-ups

<table>
<thead>
<tr>
<th></th>
<th>Euro area</th>
<th>EA periphery 2/</th>
<th>EA core 2/</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall PMR</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Professional services</td>
<td>0.9</td>
<td>2.6</td>
<td>2.3</td>
</tr>
<tr>
<td>Administrative burden on start-ups</td>
<td>1.3</td>
<td>1.9</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Sources: OECD (2013); and IMF staff estimates.
Notes: 1/ Averages are PPP-GDP weighted; 2/ EA periphery includes Greece, Ireland, Italy, Portugal, and Spain; EA core includes Austria, Belgium, Finland, France, Germany, and the Netherlands; 3/ Three countries with least restrictive regulations.

**Labor Market Institutions 1/**

- EPL for regular employment (index from 0/least to 60/most restrictive, 2008) 2/
- Tax wedge (percentage of total labor compensation, 2011)
- ALMP (percentage of GDP per capita, 2010)

<table>
<thead>
<tr>
<th></th>
<th>Euro area</th>
<th>EA periphery 3/</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPL</td>
<td>24.3</td>
<td>20.4</td>
</tr>
<tr>
<td>Tax wedge</td>
<td>42.4</td>
<td>39.2</td>
</tr>
<tr>
<td>ALMP</td>
<td>1.3</td>
<td>1.9</td>
</tr>
</tbody>
</table>

Sources: OECD (2013); and IMF staff estimates.
Notes: 1/ Averages are PPP-GDP weighted; 2/ The original index is multiplied by 10; 3/ EA periphery includes Greece, Ireland, Italy, Portugal, and Spain; EA core includes Austria, Belgium, Finland, France, Germany, and the Netherlands; 4/ OECD frontier: for EPL = three countries with least restrictive regulations; for tax wedge = three advanced OECD with lowest tax wedge; for Active Labor Market Policies (ALMP) = six countries with highest ALMP.
Roadmap

Immediate
- Macro policies

Medium-term
- Private sector deleveraging
- Fiscal consolidation

Long-term
- Structural reforms
- Completing EA architecture
The Roadmap

**Jobs and Growth**

1. Jobs and Growth: Supporting the European Recovery

**Deleveraging**

2. Growth and the Importance of Sequencing Debt Reductions across Sectors
3. Reducing the Employment Impact of Corporate Balance Sheet Repair
4. Reducing Public Debt When Growth is Slow

**Structural Reforms**

5. What do Past Reforms tell us about Fostering Job Creation in Western Europe?
6. Challenges and Solutions for Fostering Job Creation in the Balkans
7. Assessing the Gains from Structural Reforms for Jobs and Growth
8. A Disaggregated Approach to Prioritizing Structural Reforms for Growth and Employment

**Supply Chains**

9. Making Current Account Adjustment in Europe Growth Friendly
10. The Role of Vertical Supply Links in Boosting Growth
Growth and the Importance of Sequencing Debt Reductions across Sectors
Main Messages

• Leverage is high across sectors and countries

• The growth impact of high debt depends on which, and how many, sectors are indebted

• Getting the sequence of deleveraging right and facilitating private sector debt workouts is key
Pre-crisis balance sheet stress and post-crisis growth
Many firms are highly leveraged...

Non-Financial Corporate Sector Debt
(Percent of GDP)

2003 level  2003-07 change
2008-09 change  2010-12 change

Note: Includes intercompany loans, see Cussen and O'Leary (2013).
Source: ECB. First observation for the Netherlands is 2005.
...and in distress

**Corporate Insolvencies**
(Index, 2007/08 = 100)

- France
- Germany
- Ireland
- Italy
- Netherlands
- Portugal
- Spain

**Increase in Corporate Insolvencies**
(2008-12 growth, in percent, by sector)

- Tradables
- Non tradables
- Overall change

Source: Creditreform, IMF Staff Estimates.
Household debt is high...

**Household Sector Debt**
(Percent of GDP)

Sources: ECB. First observation for the Netherlands is 2005.
...and buffers are low

Assets may be high but illiquid

Net Liquid Assets of Indebted HHs
(Percent of annual gross income)

Debt service is high relative to income

Debt Service of Indebted HHs
(Percent of gross income)

Source: ECB.
Corporate deleveraging has barely started.

Corporate Deleveraging Episodes
(Corporate debt, percent of GDP)
Unprecedented credit boom and lengthy deleveraging ahead

Household Deleveraging Episodes
(Household debt, percent of GDP)
Income growth supported deleveraging in the past

Decomposition of Household Deleveraging Episodes
(percentage points of disposable income)

Source: WEO, Haver Analytics, OECD.
Sovereign debt is at historic highs

**Gross Debt, 1945—2012**
(Percent of GDP)

Sources: Historical Public Debt Database, IMF Fiscal Monitor, IMF World Economic Outlook, and Fund staff calculations.
The Impact of High Debt on Growth
(by sector and indebtedness of other sectors, estimated coefficient)
## Policy Implications

<table>
<thead>
<tr>
<th>Macro</th>
<th>Micro</th>
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<tbody>
<tr>
<td>– Sequencing across sectors</td>
<td>– Insolvency frameworks</td>
</tr>
<tr>
<td>– Structural reforms to</td>
<td>– Support debt workouts</td>
</tr>
<tr>
<td>foster growth</td>
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</table>
What do Past Reforms tell us about Fostering Job Creation in Western Europe?
Main Messages

• The crisis has laid bare pre-existing weaknesses, including an inadequate response to the technology and globalization shocks.

• Partial solutions resulted in a high degree of labor market duality in many countries.

• This exacerbated the effect of the crisis, especially for the young.

• Only comprehensive and country-specific reforms can tackle these structural weaknesses, reduce unemployment and mitigate the social cost of restructuring.
Diverging Labor Productivity

Labor Productivity per Hour Worked (Index, 1995=100)

Source: Klems database.
Note: EU-15 comprises Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom.
Convergence Growth in the EU

Convergence growth in European Union

Sources: AMECO database; and IMF staff estimates.
Four Models

- **Anglo-Saxon** countries, featuring limited government intervention, small role for unions, decentralized bargaining allowing for substantial wage dispersion, low labor taxes, and employment-linked social benefits and active labor market (ALM) policies.

- **Continental European** countries, featuring large role for unions and centralized bargaining, high labor taxes, generous UI, and, in some cases, strong EPL.

- **Mediterranean** countries, relying heavily on stringent EPL and centralized bargaining, but offering low UI and limited ALM policies.

- **Scandinavian** countries, relying more on UI rather than EPL to address unemployment risk, and also featuring high labor taxes, large role for unions, and compressed wage structures.
Labor Institutional Arrangements

Evolution of Labor Institutional Arrangements

1. Employment Protection Legislation
   (months of advance notice plus months of severance pay)

2. Ratio of Minimum Wage to Median Wage

3. Unemployment Benefits Coverage
   (ratio of beneficiaries to number of unemployed)

4. Unemployment Benefits Gross Replacement Rate
   (average over 2 years)

Source: Aleksynska and Schindler (2011).
Labor Force Participation Rate

Source: OECD database.
EPL and Share of temporary workers, 1995-2007

Sources: Eurostat; and OECD.
Spain

Spain: Employees on Open-Ended and Temporary Contracts

Open-Ended Contracts (Index, 2007=100)

Temporary Contracts (Index, 2007=100)

Source: Eurostat.

Sources: Istituto nazionale di statistica (Istat); and IMF staff calculations.
Unemployment is too high

**Unemployment**  
(Percent of labor force)

**Youth Unemployment, Nov. 2013**  
(Percent of labor force, age 25 and below)

Sources: Eurostat, Haver Analytics, IMF World Economic Outlook and Fund staff calculations.

Sources: Eurostat, Haver Analytics and Fund staff calculations.
Conclusions

• Unemployment is still too high (especially for the youth)

• The increase in unemployment during the crisis is due also to pre-existing weaknesses

• There is no unique silver bullet and solutions are country specific

• Addressing labor market problems also requires a comprehensive plan
The Role of Vertical Supply Links in Boosting Growth
• Supply chains play a key role in exports

• Linking can bring potentially large benefits, including to Euro area periphery

• Policies should aim to ensure competitiveness, identify niche sectors and provide an enabling environment for trade
Exports have driven growth

**Real GDP and Exports, World and Europe**
(Index, 2000 = 100)

Source: IMF, World Economic Outlook database.
Supply chain in action: Nutella

Source: Ferrero, Sourcemap and various on-line sources.
Key Questions

- How are supply chains beneficial?
- What factors help countries to link?
- What are the implications for Euro Area periphery recovery?
Relationship between Foreign and Domestic Value Added (Percent of GDP)

Increase in foreign value added/GDP, 1995–2008

Increase in domestic value added/GDP, 1995–2008

Supply chains add value
Supply chains help produce more sophisticated exports

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<tr>
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<tbody>
<tr>
<td></td>
<td>Labor-intensive</td>
<td>Capital-intensive</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>1.29</td>
<td>1.30</td>
</tr>
<tr>
<td>Hungary</td>
<td>0.68</td>
<td>1.06</td>
</tr>
<tr>
<td>Poland</td>
<td>1.95</td>
<td>1.39</td>
</tr>
<tr>
<td>Slovakia</td>
<td>1.05</td>
<td>1.61</td>
</tr>
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RCA* | < 0.5
| 0.5 < RCA < 1
| 1 < RCA < 2

* Revealed comparative advantage is defined as the share of a sector in a country’s total gross exports relative to the world average of the same sector in world exports.
How to establish supply links

• We use an augmented gravity model

• Three types of variables:
  
  – **Gravity variables** (GDP, GDP pc, distance, common language, common border)
  
  – **Policy variables** (FTA dummy, downstream tariff, exchange rate volatility, difference in ULC)
  
  – **Structural variables** (resource rich dummy, export similarity)
Gravity variables rule, policies also matter

Explaining foreign value added: contribution of variables

- Gravity variables: 88%
- Policy variables: 8%
- Structural variables: 4%
Europe: not everybody is linked
Euro area periphery better in services

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<thead>
<tr>
<th></th>
<th>Manufacturing</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Labor-intensive</td>
<td>Capital-intensive</td>
</tr>
<tr>
<td>Portugal</td>
<td>2.40</td>
<td>1.25</td>
</tr>
<tr>
<td>Spain</td>
<td>1.04</td>
<td>1.40</td>
</tr>
<tr>
<td>Ireland</td>
<td>0.13</td>
<td>0.83</td>
</tr>
<tr>
<td>Greece</td>
<td>0.4</td>
<td>0.7</td>
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* Revealed comparative advantage is defined as the share of a sector in a country’s total gross exports relative to the world average of the same sector in world exports.
Germany may not be the right hub for everybody

<table>
<thead>
<tr>
<th>Country</th>
<th>1995</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>0.02</td>
<td>0.03</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>0.03</td>
<td>0.04</td>
</tr>
<tr>
<td>Hungary</td>
<td>0.04</td>
<td>0.05</td>
</tr>
<tr>
<td>Poland</td>
<td>0.05</td>
<td>0.06</td>
</tr>
<tr>
<td>Spain</td>
<td>0.06</td>
<td>0.07</td>
</tr>
<tr>
<td>Portugal</td>
<td>0.07</td>
<td>0.08</td>
</tr>
<tr>
<td>Ireland</td>
<td>0.08</td>
<td>0.09</td>
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<tr>
<td>Greece</td>
<td>0.20</td>
<td>0.25</td>
</tr>
</tbody>
</table>

Source: Authors’ calculation using world input-output table based on Timmer (2012).
Note: A higher value indicates lower export similarity.
Conclusions

• Supply chains are central to increasing exports

• Prospects for Europe, including euro area periphery countries, are bright

• Structural reforms that help growth can also help establish supply links
More information at

Thank you!