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Green Shoots in a Frosted Europe: Troubled Economies are Regaining Labor Competitiveness

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The Conference Board has released an Executive Action Report about this topic today, titled "Despite the Chaos, Europe's Economies Are Regaining Competitiveness through Improvements in Unit Labor Cost Performance." Click here to download this report.

While the European financial system is cracking under its own weight, unemployment is at record highs in many countries, and no short-term solutions to Europe's problems can be expected. However, despite this crisis there are some positive points to be noted. Over the past years, structural changes have taking place which have aided in rebalancing the troubled European economy.

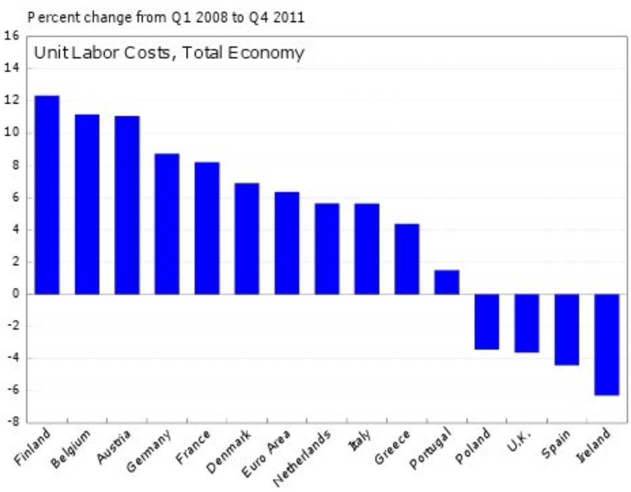
As the troubled economies in the Euro Area cannot devalue their currencies, the way to regain competitiveness is through lowering their labor costs. Because labor costs do not signify a great deal about the state of the economy, cheap labor can be incredibly unproductive and not give much output, economists often look at Unit Labor Costs (ULC), which is a ratio of compensation per hour to output per hour. It essentially shows to evaluate how much 'bang for your buck' employers receive in relationship to the compensation paid.

As it turns out, all troubled economies have made improvements in ULC over the past years. Since 2008, Ireland has decreased its labor costs per unit of output produced by 6.3 percent when the European economic crisis began. Spain managed to decrease its ULC by 4.4 percent. Greece and Portugal saw rising costs until 2009, but have started making improvements in the last two years. Most of this change was helping to drive labor compensation down, while some countries also saw increasing productivity. As Germany and other stronger European countries actually saw increases in ULC of around 8 to over 12 percent, a rebalancing seems to have started.

Of course, the loss of employment and lower average compensation cannot continue forever, and is painful in the short-term as it affects people's wealth and consumption. The positive effects will appear in the mid- to long-run, as some industries will regain an edge. In the case of Greece and Portugal, most economic potential will occur in the low-tech industries, for which ULC is most important. Ireland on the other hand, has already seen a structural shift in the manufacturing sector towards more high-tech industries in which it has gained competitiveness.

So is all of this blood, sweat, and tears going to pay off in the end? Not if confidence -- and with that -- investment won't return. However, this is a good start and an encouraging sign that adjustments within the Euro Area are indeed possible. Yet, if the downward spiral continues in some countries, such as Greece and Spain appear to be in, this will only lead to a hollowing out of the economy. The troubled economies remain in dire need of help from the European policy makers. At the moment, they hold the key to return of investment, and, with that, the start of the European economic spring.

Change in Unit Labor Costs in the total economy



Source: The Conference Board

Note: latest data for Ireland, Netherlands, Poland, Portugal and U.K. are Q3 2011

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Bert Colijn is a labor market economist that focuses on the European market. He works on the European Commission FP7 project NEUJOBS, focusing on productivity and economic growth in Europe in 2025. Be…

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