Introduction

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Following four years of decline, unemployment rates started to climb in Europe from 2009 onwards to reach record levels that had not been seen since the mid-1990s, with an EU average of 10.9 per cent of the labour force in 2013, while the euro-zone unemployment rate reached an all-time high of 12 per cent the same year. The experience of member states varied substantially, however. In 2013, Greece and Spain had unemployment rates of 27.5 and 26.1 per cent, respectively, whereas the jobless rates in Germany and Austria were 5.2 and 5.4 per cent (AMECO database). This book broadly sets out to investigate why unemployment has risen more in some countries than in others since 2008 and how far this relates to the policies pursued.

To answer this question, one inevitably needs to consider the experiences of countries in the context of the economic crisis that has marred the EU and especially the euro zone since 2008, initially as a result of the global financial crisis and subsequently as a result of the multiple crises of sovereign debt, balance of payments and banking and the policy responses to them. We therefore qualify our broader question to ask whether the developments and policies aimed at achieving the goal of internal devaluation can account for this variation and if so, how. More specifically, has internal devaluation helped to reduce unemployment, as advertised, or has it, on the contrary, contributed to its rise and if so, in what ways?

Europe in crisis

The first years of EMU, up until 2008, were characterised by the build-up of current account imbalances within the euro zone and the divergence of real exchange rates; that is, of inflation rates and unit labour cost growth among member states. Research has shown that the drivers of these imbalances were divergent domestic demand developments and
not unit labour costs (Gaulier and Vicard 2012). Member states in the southern periphery countries enjoyed a reduction in interest rates on joining the single currency, which boosted their economies. Their inflation rates rose as a result, which meant that their real exchange rates appreciated, but also – and more importantly as it turned out – that their real interest rates fell, further fuelling demand. At the same time, monetary integration brought about more financial integration. As a result, increased demand on the periphery could be financed by credit flows from the core euro zone, where subdued demand meant that there were higher savings seeking high returns (Burda 2013). Increased demand led to higher prices and wages, as labour markets became tighter. In several member states, these credit flows financed a construction boom and led to housing bubbles.

Thus, although the euro zone as a whole had a balanced current account, imbalances built up between the core and the periphery. On the periphery, current account deficits were linked to increased borrowing either by the private (Ireland, Spain) or the public sector (Greece), financed by credit flows from the north. The fact that there was no EU regulation of financial markets and macro-prudential policies meant that there had been only weak constraints on over-lending (Martin 2014). It was up to lenders to assess the repayment risk of their borrowers.

When the global credit crunch occurred in 2008, market sentiment changed dramatically and financial market agents started to reassess their exposure, becoming more cautious. Credit flows dried up, which caused the first recession of 2008–2009. The second recession then followed a switch towards policies of fiscal restraint across the EU. A special role in this was played by Greece after questions arose about that country’s capacity to continue servicing its debt, given that, as a member of EMU, it had no central bank to back it as lender of last resort (De Graauwe 2011). From 2008 onwards the interest rate at which the Greek government could borrow to roll over its debt started rising and eventually reached a prohibitively high level. As the creditworthiness of the government was cast into doubt, so was the creditworthiness of Greek banks and companies who were borrowing from the financial markets, regardless of the soundness of their balance sheets (Pisani-Ferry et al. 2013). Thus, the first episodes of 'sudden stops' of private financial flows which hitherto had been financing demand occurred in late 2008 and continued till 2010, when the Greek government requested and received a bail-out package (Merler and Pisani-Ferry 2012). The crisis appeared
to be a sovereign debt crisis, but at the same time was a peculiar type of balance of payments and banking crisis (Pisani-Ferry et al. 2013). The lack of effective crisis mechanisms at the euro zone/EU level in the wake of the Greek debt crisis soon led to contagion to other member states. Portugal, Spain, Ireland and Italy all saw the interest rates at which their governments could borrow on the financial markets soar, with sudden halts occurring there, too.

All these crises have triggered recessions in the affected member states from which the EU and the euro zone have not recovered in 2015. The fact that the recessions were caused by the sudden reverse in private credit flows meant that the shock had particular repercussions for activities that had been hitherto financed by them, such as construction, thus concentrating job losses in them. Real output in the EU barely exceeded its 2008 value in 2014, whereas in the euro zone in 2014 it was still below that of 2008. This weak recovery has been attributed to the economic policy choices that were made first in some member states (the Baltics) in 2008–2009 and then on a wider scale from 2010 onwards, especially in the euro zone (Wren-Lewis 2015)).

**Internal devaluation**

The bailouts to countries affected by a sovereign debt crisis were granted conditional upon the implementation of economic adjustment programmes. Responsible for spelling out the programmes and monitoring their implementation was the so-called ‘Troika’ of institutions: the European Commission, the European Central Bank and the International Monetary Fund. Two of the main pillars of the policy responses to the economic crisis are fiscal austerity and internal devaluation. A standard tool for adjusting balance of payments crises is real exchange depreciation, that is, making the prices of domestically produced goods and services relatively cheaper than those produced in countries in relation to which it has a current account deficit. In flexible exchange rate regimes, real exchange rate depreciation is facilitated in the short run by a depreciation of the nominal exchange rate. However, when a country has adopted a fixed exchange rate regime (for example, a currency board or a hard peg, as in the Baltic states) or has joined a monetary union, then internal devaluation – that is, a relative downward adjustment in production costs, notably nominal wages, and prices – is the only way to adjust the real exchange rate in the short run. Productivity growth is another way forward.
However, the latter requires multiple policy levers to be pulled in combinations often not completely known to policymakers (Mayhew and Neely 2006), while the effects take time to emerge.

In Europe, internal devaluation was first adopted in the Baltic states which, even though they did not belong to the euro zone, chose to maintain currency pegs/boards, while pursuing adjustment policies against their balance of payments crises. When the euro-zone crisis began, reforms of both labour and product markets were recommended, although the effects on labour costs have been more pronounced. It is crucial to note that the implementation of internal devaluation in the euro zone has been asymmetric. In other words, the burden of adjusting real exchange rates – a relative variable – within the euro zone has fallen exclusively on the member states with current account deficits. A less painful approach would have been if member states with current account surpluses (for example, Germany) had also taken action to produce an internal revaluation of their real exchange rate by increasing demand in their economy. More expansionary fiscal or monetary policies could have helped in that direction. However, fiscal policies have been constrained by the EU fiscal rules, whereas until 2013 the ECB was fairly reticent in its responses to recession in the area.

Given that cuts in nominal wages are difficult to pursue and undesirable even for employers, as they harm employees’ morale and motivation (see Bewley 1999), internal devaluation is a painful process insofar as it typically requires that unemployment rises in order to put pressure on wage demands in the private sector. Policies used to precipitate internal devaluation include fiscal austerity and structural reforms that increase the responsiveness of wages and prices to economic pressures, such as recession and unemployment. This is also why the prospect of having to use internal devaluation as a means of adjustment to asymmetric shocks – that is, shocks that affect only a part of the monetary union area but not others – has been mentioned as one of the costs that countries considering whether to join a monetary union would probably have to incur (De Grauwe 2014).

Internal devaluation is meant to make the relative prices of goods and services in an economy relatively cheaper than those of its trading partners. In principle, that should make its exports relatively cheaper and its imports relatively more expensive. To the extent that the demand for its exports depends on their price, and other things (such as foreign
demand) being equal, this should lead to higher export demand. Moreover, if imports become relatively more expensive, it is possible that they will be substituted for by domestically produced products. If both these effects happen, then net exports are assumed to increase and so will aggregate demand. Internal devaluation also involves changes in the relative prices of a country’s own tradable and non-tradable sectors in favour of the former with the aim of transferring resources from the non-tradable to the tradable sectors.

Whether such a strategy can expand exports depends on many assumptions that are not always realistic or sound. First, the demand for exports must be sensitive to price changes. This is more likely to be the case for low-technology products. Second, in the case of reducing unit labour costs, labour costs have to constitute a substantial part of total costs, so that a given reduction goes a long way in reducing production costs. Third, there must be sufficient export capacity to accommodate any increase in demand. Even, however, if these conditions applied, it is still questionable how far an increase in demand for exports could stimulate employment creation insofar as tradable sectors are often not the most labour intensive, while they typically account for a relatively smaller share of employment in an economy.

While these potentially positive effects are predicated on several assumptions, the effects of lower wages in an economy that has already suffered a recession are much more direct, as they are associated with lower incomes and consumption. Labour market reforms aimed at reducing the bargaining power of wage-setters have been shown to have adverse short-term effects on demand, as they lower income security and increase employment volatility.

Analysts often refer to the real exchange rate of a country as ‘competitiveness’ and, consequently, to its depreciation as an ‘increase in competitiveness’. The relative prices of an economy’s goods and services may have some role to play in its export performance in the short run, when technology, capital and human capital stock and, therefore, productivity are given. Depending on how price elastic their demand is, the notion of competitiveness of an economy in the longer run – unlike companies – is less meaningful and its use as an important objective for guiding economic policies has been criticised (Krugman 1994). Instead, the quest for sustainably good macroeconomic performance in the long term depends on domestic productivity growth (ibid.) and increasing
specialisation in the production of goods and services of high quality and added value. The latter allow a country to finance its imports and to not compete with regard to prices and costs, so that economic activity and a sustainable current account balance can also be compatible with rising living standards (Mayhew and Neely 2006).

When discussing the effects of internal devaluation in the euro zone it is, therefore, important to distinguish between internal exchange rate adjustment (devaluation or revaluation) as a means of adapting to asymmetric shocks and internal devaluation as a strategy for improving economic performance. The current account imbalances that emerged in the euro zone reflect divergent domestic demand developments rather than export performance (European Commission 2009, 27) and thus some realignment of relative prices is required across the euro-zone member states. Ideally, that should take place in both deficit and surplus countries, with devaluations and revaluations. However, in several instances the policy recommendations imposed on member states that received financial support made unilateral relative price adjustment the main driver for improving macroeconomic performance. It is in this context that labour market reforms have been advocated in order to push wages down further, but also – more broadly – to promote labour market flexibility.

As has often been the case since the 1990s, however, increasing labour market ‘flexibility’ has been taken to be synonymous with deregulating labour markets, although this is by no means automatic (cf. Stanford 2005). The notion of ‘flexibility’ itself has been limited to numerical adaptation (facilitating the hiring and firing of employees in response to demand fluctuations), wages (making it easier for employers to adjust wages in accordance with labour market conditions or productivity) and, to some extent, working time (enabling employers to vary the number of hours worked in a given period in response to demand) (cf. Regini 2000). Despite the empirical research that positively challenges this view (see e.g. Howell 2005; Bassanini and Duval 2006; Theodoropoulou 2008), the notion that labour market deregulation leads to better labour market and macroeconomic outcomes obtained a new lease of life in the EMU context. However, rather ironically, in most of the member states whose unemployment rates have remained the lowest in the EU and the euro zone, labour markets are anything but deregulated, in that employment and compensation outcomes are deliberately regulated through policy interventions by governments or/and the social partners. Working-time
and functional flexibility (the ease with which the work performed by employees can be adapted to demand fluctuations; Regini 2000) are prevalent in these labour markets (for example, Germany, Austria and the Netherlands).

Looking beyond unemployment

Assessing the effect these policies have had on unemployment requires careful analysis. Although the unemployment rate is the usual measure that policymakers employ in policy debates, we take a more thorough approach and look in more detail at the labour market dynamics underlying the changes in headline indicators, such as employment and unemployment. This is important not only in order to fully grasp the multitude of processes that underlie the movement in headline employment indicators – the latter are all too often taken at their face value as a measure of the success (or lack of success) of policies – but also in order to assess the effects of the crisis on the quality of employment.

Changes in the unemployment rate can be driven by changes in the population. Indeed, in most troubled countries during the crisis emigration increased or remained at a high level and labour supply was reduced as a result, although this might not involve ‘exporting’ the unemployed. Nevertheless, even with an unchanged number of jobs, existing positions would need to be allocated among fewer people and, as a result, have a positive effect on the unemployment statistics. Another avenue of labour force reduction was an increased rate of transitions to inactivity, as workers discouraged by unsuccessful job search exited the labour market altogether. Policies aimed at reducing unemployment benefits by tightening conditionality or limiting their duration were arguably a factor in further reductions in unemployment because there was little incentive to report oneself unemployed.

On the other hand, employment or unemployment rates do not take into account other labour market dynamics. Thus, a change in the number of people in employment does not necessarily correspond to a proportional change in the number of available jobs. Job creation in terms of temporary, short-term or part-time employment – all increasingly involuntary – has contributed substantially to the redistribution of available work across an increasingly precarious workforce. Accordingly, either the actual number of employed has remained stable despite the
apparent improvement in employment indicators (for example, Germany and Poland), or the severity of labour market decline was masked (for example, Greece, Spain and Ireland). This is illustrated in Table 1, which compares changes in employment rates and total hours worked between 2007 and 2014. Thus, for most of the countries analysed in this book, changes in employment or unemployment rates not only inflate any signs of improvement, but also fail to show increasing precariousness of jobs.

Table 1  Evolution of employment rates and total hours worked in selected EU countries, 2007–2014 (indexed 2007=100)

<table>
<thead>
<tr>
<th>Employment rates</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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<tbody>
<tr>
<td>EU 28</td>
<td>100.8</td>
<td>98.8</td>
<td>98.3</td>
<td>98.5</td>
<td>98.3</td>
<td>98.3</td>
<td>99.4</td>
</tr>
<tr>
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<td>98.5</td>
<td>97.9</td>
<td>98.0</td>
<td>97.3</td>
<td>96.8</td>
<td>97.4</td>
</tr>
<tr>
<td>Germany</td>
<td>101.6</td>
<td>101.9</td>
<td>103.0</td>
<td>105.4</td>
<td>105.8</td>
<td>106.5</td>
<td>107.0</td>
</tr>
<tr>
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<td>97.4</td>
<td>89.5</td>
<td>86.1</td>
<td>85.1</td>
<td>85.0</td>
<td>87.4</td>
<td>89.2</td>
</tr>
<tr>
<td>Greece</td>
<td>100.8</td>
<td>99.8</td>
<td>97.0</td>
<td>90.5</td>
<td>83.4</td>
<td>80.1</td>
<td>81.1</td>
</tr>
<tr>
<td>Spain</td>
<td>98.0</td>
<td>91.2</td>
<td>89.4</td>
<td>88.1</td>
<td>84.8</td>
<td>83.3</td>
<td>85.1</td>
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<td>98.0</td>
<td>96.9</td>
<td>96.9</td>
<td>96.6</td>
<td>94.7</td>
<td>95.1</td>
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<td>104.0</td>
<td>104.7</td>
<td>105.3</td>
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<td>94.4</td>
<td>90.8</td>
<td>89.6</td>
<td>92.6</td>
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<tr>
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<td>96.9</td>
<td>97.8</td>
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<table>
<thead>
<tr>
<th>Total hours worked</th>
<th>2008</th>
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<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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<tr>
<td>EU28</td>
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<td>96.9</td>
<td>96.6</td>
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<td>97.4</td>
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<tr>
<td>Germany</td>
<td>101.1</td>
<td>99.1</td>
<td>100.7</td>
<td>100.6</td>
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<td>101.0</td>
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<td>Ireland</td>
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<td>87.1</td>
<td>83.3</td>
<td>81.5</td>
<td>80.9</td>
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<tr>
<td>Greece</td>
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<tr>
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<td>89.2</td>
<td>87.5</td>
<td>82.8</td>
<td>80.6</td>
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<tr>
<td>Italy</td>
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<tr>
<td>Poland</td>
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<td>102.7</td>
<td>99.8</td>
<td>100.1</td>
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<tr>
<td>Portugal</td>
<td>100.4</td>
<td>97.7</td>
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<td>93.9</td>
<td>89.2</td>
<td>87.7</td>
<td>90.2</td>
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<tr>
<td>UK</td>
<td>99.9</td>
<td>97.8</td>
<td>97.5</td>
<td>97.6</td>
<td>99.0</td>
<td>100.2</td>
<td>102.6</td>
</tr>
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</table>

Source: Eurostat, authors’ calculations. Total hours worked = number of employed * average actual hours worked, employees 15–64 years of age.
Selection of country case-studies and outline of the book

Given the complexity of the factors shaping unemployment and labour market performance more generally an appraisal of the policies of internal devaluation and the extent to which they contributed to changes in unemployment and employment requires detailed case studies. For this purpose, we chose countries that pursued internal devaluation after 2008 due to the country-specific adverse demand shocks they experienced. These case studies include (in chronological order of receiving financial support from the EU and, in most cases, the IMF) Greece, Ireland, Portugal and Spain. We also look at Germany, where internal devaluation was pursued in the early 2000s – when the macroeconomic climate in Europe was more positive – in order to investigate how its effects were different under such conditions. Last but not least, we include two case studies of countries that are not part of the single currency and do not have an exchange rate peg, namely Poland and the United Kingdom. Given that, as already mentioned, at the heart of internal devaluation strategies lies the notion that labour market deregulation leads to better macroeconomic outcomes – however defined – these two countries, which have pursued labour market deregulation for some time, allow us to see whether, and if so how, this notion holds water.

Greece

Greece, discussed in Chapter 1 by Sotiria Theodoropoulou, was the country in which the euro zone’s sovereign debt crisis started out and was the first euro-zone member to receive a bailout in May 2010. Six years after the onset of recession and two harsh economic adjustment programmes later, Greece has lost more than 25 per cent of its real GDP, while in early 2015 it had the highest unemployment rate in the EU (27 per cent). Although there is no doubt it was the recession that led to higher unemployment, the increase in Greece, as in Spain, was even higher than would have been expected from the decline in output.

The chapter reviews the potential reasons for this discrepancy and focuses in particular on whether internal devaluation can also be held responsible for it. The author argues that the large concentration of job losses in the construction sector, in which informal employment is prevalent, and the loosening of employment protection legislation while the real economy was in free fall intensified the effects of the recession
on unemployment. Moreover, fiscal austerity and reforms of the collective bargaining system, which led to further deregulation, undermined any possibility of concerted tripartite action to help soften the impact of the adjustment. Internal devaluation was bound to be a risky approach in a country as closed to trade as Greece and with a narrow export base, where labour costs represent only a small proportion of value added. Nominal unit labour costs declined after 2010, but the effect was not fully passed on to prices. Real wages fell, dragging down domestic demand – including the demand for imports – but without having any discernible effect on export volumes. As the recession thus became a depression, financial distress in the Greek economy increased, hindering the much needed investment that could help to restart and restructure it. Thus, internal devaluation, although successful in helping to rebalance the current account deficit, has in fact contributed to intensify the effects of recession on unemployment.

Ireland

Tom McDonnell and Rory O’Farrell (Chapter 2) show how in Ireland the government chose to deal with the banking crisis with a rescue package, agreed with the Troika in 2011, which imposed austerity policies. As a consequence, the country experienced its longest recession in over a century, with declining GDP and an unemployment rate that peaked at 15.1 per cent. The biggest declines in employment were in construction and retail, while there was growth in health and information and communication technology. Even though unemployment started falling after early 2012, the labour force was more than 10 per cent smaller in 2014 than in 2007, with emigration explaining much of the difference between changes in employment and those in unemployment.

Although the term ‘internal devaluation’ was rarely used in Ireland, policymaking was clearly influenced by the argument that weak competitiveness was fundamental to the country’s problems and that it could be solved by reducing relative wage costs. This was targeted by reducing public sector pay – although that need have no direct impact on export costs – and by changing wage-setting mechanisms. However, analysis of the effects of internal devaluation shows that relative wage costs explain neither the origins of the crisis nor the behaviour of the economy after the introduction of austerity. A more plausible narrative shows Ireland suffering from an asset-price bubble. When this burst in
2008 the effect was a dramatic drop in construction activity and employment. There was an apparent improvement in relative unit labour costs, but that was largely the result of structural changes in the economy away from sectors with lower unit labour costs, notably construction. An improved balance of payments position was largely due to reduced imports following lower domestic demand.

Portugal

Portugal, as discussed in Chapter 3 by António Bob Santos and Sofia Fernandes, was the third euro-zone member state to receive a bailout and a conditionality programme in May 2011, following agreement with the Troika. The programme included the classic recipe of fiscal austerity and policies aimed at facilitating internal devaluation. The terms were based in part on the assumption that Portugal’s problems followed from a loss of competitiveness due to increasing relative unit labour costs. The solution was to adopt policies that reduced pay levels by freezing the minimum wage, reducing employment protection across the economy and cutting public sector pay. The result was a further rise in unemployment, to 17.5 per cent. Claims that there has been some sort of recovery are highly questionable.

Among other things, the chapter pinpoints three important areas in which policies adopted in 2011 were failing. The first is employment, with an apparent fall in unemployment from its peak explicable largely in terms of emigration and of people dropping out of the labour force altogether. The second is the external balance, which improved primarily thanks to reduced imports because of lower internal demand. There was an increase in exports, but rather than following from pay reductions within the framework of internal devaluation, this is most accurately seen as a continuation of pre-crisis trends. The third area is the long-term prospects of the Portuguese economy. Here the authors demonstrate that difficulties followed not from high wages – unit labour costs increased in previous years in line with the euro-zone average – but from structural problems. Portugal had wage levels that were too high to compete in less sophisticated products but human capital levels that were too low for competition in more sophisticated products. The solution includes an emphasis on research, innovation and enhanced skill levels. The policies pursued since 2011 led to cuts in precisely these areas.
Spain

Spain, discussed in Chapter 4 by Jorge Uxó, Eladio Febrero and Fernando Bermejo, received financial support for recapitalising its banks in July 2012. Thus although its government did not receive a bailout for its public debt, the country had to implement financial support–related condition- alities, pursuing fiscal austerity and internal devaluation. Reduced public spending, following increases in 2009 to provide an anti-crisis stimulus, and reduced employee protection were followed by a continued rise in unemployment, which peaked at almost 27 per cent, falling slightly through 2014. By following linkages between sectors, the authors show the extent of the dependence of declining economic output on the construction sector, with this and real estate accounting for 82 per cent of the employment fall between 2007 and 2009.

Thus Spain’s crisis followed very clearly from the credit-fuelled construction boom. The main effect of policies pursued from 2010 was further to reduce domestic demand levels, causing the continuing rise in unemployment and depression in investment. There was an improvement in the external balance, but this was a result overwhelmingly of lower demand. Wage cuts leading to lower unit labour costs were of little importance for exports. Indeed, lower wages were not passed on to lower prices, partly because of the effects of higher indirect taxes, but also to a large extent because profit levels increased.

Germany

The case of Germany is examined by Steffen Lehndorff in chapter 5. Germany was the pioneer of internal devaluation in the euro zone, as, following its EMU entry at – arguably – an overvalued real exchange rate, it sought to realign it through real wage growth consistently below productivity growth. This involved policy measures that contributed to bring down collective bargaining coverage, pay stagnation, growth of a low-wage sector and increased inequality. The case study allows us to see the effects of internal devaluation under more favourable macroeconomic conditions than the currently critical ones in the euro zone.

When the crisis struck, the German reaction included negotiated measures for preserving employment through internal flexibility and changes in working time. In the following years there was arguably some
reversal of internal devaluation, with negotiated pay increases, albeit not on a large scale.

German policy before the financial and economic crisis has been used to justify internal devaluation elsewhere in subsequent years, but this is not valid, for two main reasons. First, much of Germany’s export success was based on non-price factors: pay restraint was more important in holding down consumption and hence imports, thereby limiting demand and growth potential for other euro-zone members. Indeed, the high profit levels of German businesses at a time of pay restraint were a source of precisely those funds that fuelled credit growth elsewhere, thus contributing to crises of indebtedness. The second reason for not advocating the same policy everywhere else follows from this: if all countries were to pursue internal devaluation the effect would be to depress demand for all. Germany had been able to export, to a great extent, precisely because other countries had been pursuing more expansionist policies.

United Kingdom

The UK experience, discussed by Steve Coulter in Chapter 6, differs from those previously considered as the country was never a euro-zone member and experienced a significant currency devaluation in 2007. Policies also arguably created a more favourable macroeconomic environment for employment creation. However, using this as a control case throws up some significant oddities that cannot easily be explained. Despite devaluation, the United Kingdom did not experience an export boom. In fact its external balance, taking the current account alone, was consistently less favourable than that of any other EU member state and productivity performance was exceptionally weak. Also, unlike previous UK crises and those in other EU member states, a fall in real wages was accompanied by relatively stable levels of total employment, with the 2008 level surpassed in 2012, albeit with an increasing emphasis on less secure forms of employment. There were further unusual features, with employment conditions becoming more favourable for older cohorts, a strong increase in self-employment and a shift from public to private sector employment.

Three explanations, not mutually exclusive, are considered for these labour market developments. The first is that real wage reductions were
the key to preserving employment. This is consistent with the available data, albeit with the obvious caveat that jobs were preserved in aggregate by worsening pay and conditions, with an accompanying fall in productivity. The second is the possibility that employers were hanging on to employees, who, in turn, were accepting pay reductions. The third is that active labour market policies, although a small part of public spending, were unusually effective.

Poland

Like the United Kingdom, Poland experienced a currency devaluation as the crisis broke out. It also continued GDP growth, albeit at a slower pace than in preceding years. As this followed measures to create a more flexible labour market in earlier periods, the obvious question is whether that was important in the country’s apparent resilience in the face of external shocks. Małgorzata Maciejewska, Adam Mrozowicki and Agnieszka Piasna investigate this in Chapter 7, following the policies pursued in previous decades which had strong similarities to measures adopted elsewhere in later years under ‘internal devaluation’. They therefore refer to Poland suffering from a longer-term ‘crawling’ crisis during which measures to create flexible labour markets were adopted. The result from the early 2000s was a framework for a very high level of flexibility thanks to forms of very precarious employment. That coincided with an inflow of foreign investment, which contributed to export and GDP growth. It also coincided with lower unemployment before the crisis and possibly to greater adaptability of employment during the crisis, when further steps were taken in the direction of flexibility.

However, it is not valid to draw links between employment policies and areas of apparent economic success. Reduced unemployment coincided with emigration to seek work elsewhere. FDI came to other central European countries with different employment conditions, in all cases attracted by the pre-existing low relative pay levels. Adaptation during the crisis was not eased by a cushion of temporary jobs as it was rather permanent employment that adjusted. From 2012 unemployment began to increase again. This period saw an increasing shift towards less secure forms of employment as firms reacted by minimising employment costs. Thus the creation of a labour market offering insecure employment conditions to much of the labour force carried a high social cost with little by way of demonstrable economic benefits in return.
Conclusion

These individual country studies lead to four conclusions:

(i) Unemployment was not caused by wages that were too high. There were issues of competitiveness in some countries, but they were related to the absence of high-quality export sectors, economic structures that had not adapted from exporting low-tech products and weak support – from education and research infrastructure – for the development of such activities. In a number of very clear cases, unemployment followed from the collapse of construction after the ending of easy credit. Wage cuts have done nothing to solve this structural problem.

(ii) Internal devaluation was effective in reducing current account deficits, but overwhelmingly by reducing imports. It did not trigger higher exports. Indeed, a consistent finding is that lower wages did not lead to lower export prices. The latter, indeed, often increased, reflecting increases in taxes, input prices and, not infrequently, also profits. There were, coincidentally, cases of countries increasing export levels, but predominantly in more sophisticated and less price-sensitive products, often reflecting no more than the continuation of past trends.

(iii) Internal devaluation has led to more rather than less unemployment, albeit with the trend partially masked in several countries by emigration and growing numbers of discouraged workers who are no longer seeking employment. There is also more long-term unemployment and an increase in precarious employment, with all the social costs attached to those phenomena.

(iv) Evidence also points the way to alternative – and more effective – solutions based on improved competitiveness and more employment opportunities on the basis of quality improvement. That requires spending and investment in education, research and the like, areas that have been subjected to cuts in the interests of internal devaluation policies.
References

Introduction


http://www.voxeu.org/article/fiscal-policy-explains-weak-recovery