# Unit Labour Costs in the Eurozone

One reason for the on-going euro crisis is the difference in the development of the average cost of labour per unit of output and its effect on international competitiveness. The OECD derives those average costs from Unit Labour Costs (ULCs), which are calculated as the ratio of total labour costs to real output (OECD 2013). This ratio can also be described as the ratio of mean labour costs to labour productivity, so that ULCs link productivity to labour costs. This link makes ULCs crucial for international competitiveness. The following text examines differences in the development of ULCs in member states of the Eurozone[1] over the last twenty years based on OECD data. The development of UCLs is discussed at three different time periods: in the 1990s, after the introduction of the Euro and at the beginning of the crisis. The main focus will be on trends in ULCs in the crisis-hit countries (Greece, Spain, Portugal, Italy and Ireland), as well as on their development in Germany. The base year for all data is 2000.

From 1992 to 2000, the development of ULCs in the crisis-hit countries was already stronger than in other member states. Greece and Spain in particular, with respective levels of 59.9 and 82.2 percent of ULCs 2000 in 1993, experienced higher ULC growth rates in the 1990s than other states of the subsequently formed Eurozone, where rates ranged between 89.3 percent (Luxembourg) and 96.0 percent (Finland). Even at that time Germany's ULC development was outstanding. Its ULCs of 1993 were just 2.1 percent below the level reached in 2000, meaning that costs more or less stabilised over this period. The only country in which a similar trend was observed was Austria.

The introduction of the Euro as a common currency in 1999 led to a credit boom in the crisis-hit countries, caused by fast growth and higher public spending in a context of higher inflation compared to the Eurozone average. The inflation led to a loss of international competitiveness, as shown in the OECD statistics, due to higher prices accompanied by higher costs and the lack of any possibility of debasement. In the second observed period from 2000 to 2007, which ends on the eve of the crisis, the ULCs of Greece (128.6 percent), Spain (127.7 percent), Italy (123.6 percent), Portugal (122.3 percent) and Ireland (133.6 percent) rose strikingly more sharply than in other states, where the increase generally totalled between five and 15 percent. Germany again stood out as having almost constant ULCs from 2000 to 2003 and as seeing a decrease in ULCs, which fell below the level of 2000 by 2007. This stand-alone development is the result of labour market reforms undertaken in Germany in the context of the Agenda policy pursued during Schröder's second term in office.

In the third period since 2007, ULCs rose in the five crisis-hit states to a level ranging from 130.5 percent (Portugal) to 144.1 percent (Greece). Since 2009 the trend has changed and ULCs have started to fall[2], bringing ULCs in 2012 back to the level of 2007[3]. The only exception to this rule is Italy, where ULCs rose continuously. The decline of ULCs in crisis-hit countries has been accompanied by an increase of ULCs in Eurozone countries since 2007. Except for the period from 2009 to 2010, during which a little decrease based on the crisis can be observed, the trend of rising ULCs has continued to date. Even in Germany, ULCs rose to 108.0 percent of 2000 for the first time in 2012. While the decrease in the costs of the crisis-hit countries depends heavily on the reforms implemented, the increase in wages, especially in Germany, is based upon the positive economic climate of recent years. This slower growth in ULCs led to a reduction in trade balance deficits in recent years, due to decreasing export prices associated with a decrease in labour costs.

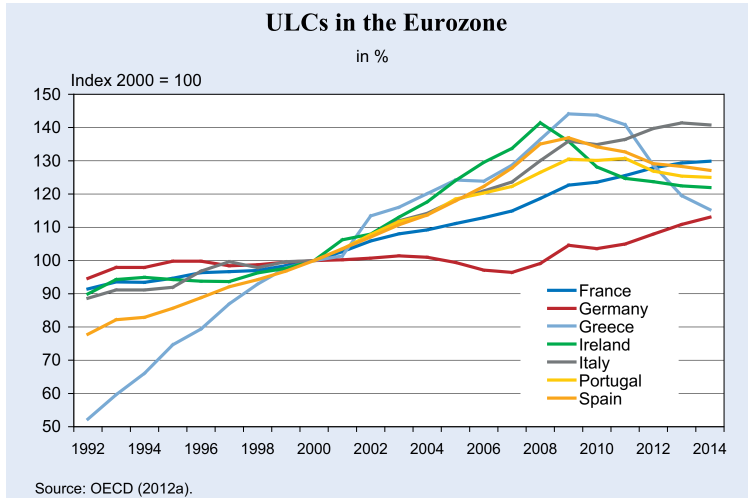
According to OECD predictions (see Figure 1), this downside trend in ULCs will continue for the next two years, so that Spain (127.0 percent), Portugal (125.0 percent), Ireland (121.9 percent) and Greece (115.0 percent) will – compared to 2000 – have smaller ULCs growth rates than most other countries, which will have a level of over 130 percent in 2014. The only exceptions are Austria (122.9 percent) and Germany, which with a level of 113.0 percent are again clearly below the average.

Since the prior adjustment of the trade balance deficits in the crisis-hit countries was attenuated by weak domestic demand and high unemployment, the

[1] I only look at the countries that introduced the Euro in 1999.

[2] In Ireland, the ULCs already started to fall in 2008.
[3] In Portugal, they are on the level of 2008.

**Figure 1**



Source: OECD (2012a).

OECD sees further need for structural reforms in the crisis-hit states. The OECD recommends economically stronger countries (OECD 2012b) – especially Germany – to implement further reforms with a policy featuring wage adjustment and a policy that stimulates demand in these countries. If further developments occur as predicted, the pressure on the crisis-hit countries exerted by ULCs will decrease.

Martin Voggenauer

## References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