Discussion of “Eurosclerosis at 40: labour market institutions, dynamism, and European competitiveness” by Benjamin Schoefer

By Nicola Fuchs-Schündeln[1]

Abstract

Over the past twenty-five years, the Euro Area has experienced sluggish productivity growth alongside low investment in new technologies. Benjamin Schoefer’s paper makes a convincing case that labour market regulation is an important factor behind these phenomena. In this discussion, I provide additional evidence on the importance of labour markets for growth. I then describe two major challenges faced by European labour markets, namely a lack of dynamism and decreasing labour supply. Last, I give first insights into the correlation between labour market flexibility and the adoption of artificial intelligence.

1 Introduction

In his thought-provoking paper, Benjamin Schoefer (2025) contrasts the “old view” and the “new view” on the link between labour market institutions and macroeconomic outcomes. The old view focuses on institutions targeted towards unemployed individuals, and is mostly concerned with a narrow set of macroeconomic outcome variables, namely unemployment rates, as well as job quality, wages, and inequality. The paper argues that we should adopt a “new view” on the role of labour market institutions, which encompasses labour market policies targeted towards employed individuals, and stresses the importance of labour market policies for a much broader set of outcome variables, specifically also innovation, investment, and growth.

I begin by summarizing the paper’s key argument that labour markets are crucial for economic growth, and provide some additional evidence supporting this claim. Then, I take a step back and broadly describe two major challenges that labour markets in the Euro Area face: institutional and cultural barriers inhibiting labour market dynamism, and decreasing labour supply. Last, I present preliminary data from ongoing research on AI adoption in Europe, connecting it to the paper’s point that

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employment protection hinders the adoption of new technologies. I conclude with thoughts on the implications of the paper's findings.

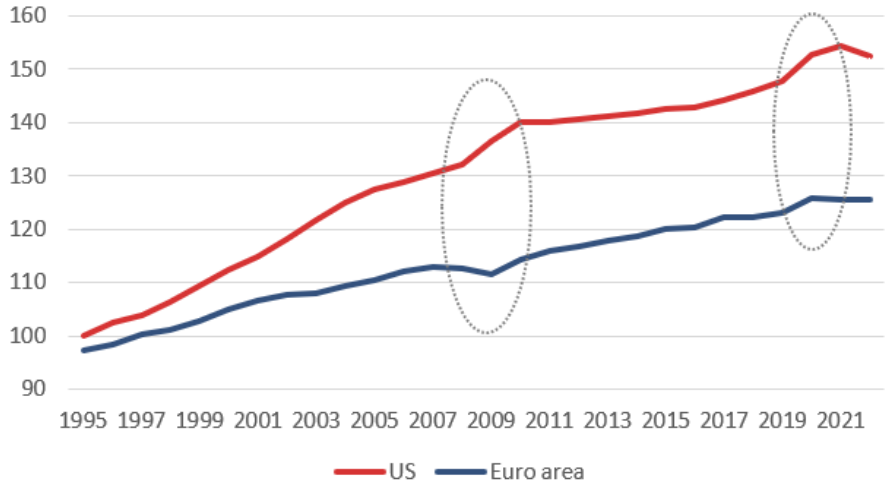
2 Labour market institutions as a driver of economic growth

Over the last three decades, the Euro Area has been suffering from sluggish productivity growth. Chart 1 depicts GDP per hour worked in the Euro Area and the US, and illustrates a growing divergence since the mid-1990s. Especially during the Great Recession and the Covid recession, both indicated in the chart, this divergence increased, and the gap remained persistently larger thereafter.

Chart 1

GDP per hour worked in Euro Area and the US

(US 1995=100)

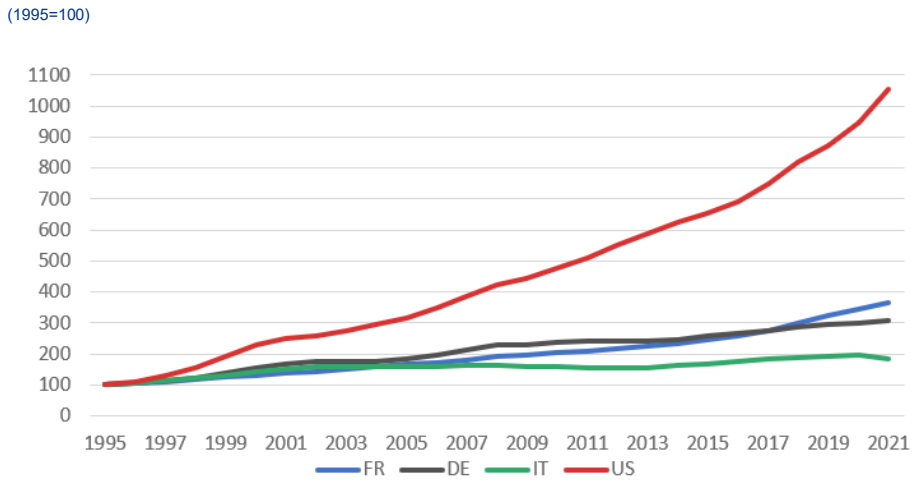


Source: OECD (2025), GDP per hour worked

It is likely that lower investment in new technologies in Europe than in the US is one of the main drivers of this divergence. A comparison of the IT-related capital stock in the US and the three largest Euro Area countries Germany, France, and Italy over the same time period reveals that US firms invested much more in IT technologies than European firms (see Chart 2).

Chart 2

Real IT-related capital stock



Source: EUKLEMS & INTANProd database, 2024 release, see Bontadini et al. (2023)
Notes: IT-related stock is the sum of capital stock net (chained linked volumes) of computing equipment and computer software & database for all NACE industries.

At the same time, the unemployment rate in Europe is largely under control nowadays. As a consequence, policymakers and researchers alike shifted their focus from labour market institutions to other institutions, such as innovation policies and financial regulation, in their attempts to explain the low European productivity growth rates. However, as Benjamin Schoefer convincingly argues in his paper, labour market institutions are a key driver of the sluggish development of Euro Area economies. While policies targeted towards unemployed individuals were successfully reformed in many European countries in the 1990s and 2000s, and these reforms played a significant role in the reduction of European unemployment rates, policies targeted towards employed individuals remained largely unchanged. However, these policies matter for the adoption of new technologies and for disruptive innovations, and thereby ultimately for productivity growth.

Policies such as employment protection (regulations that make it difficult or costly for firms to lay off employees) and codetermination (the right of workers to participate in the management of the companies they work for) focus on maintaining job matches. However, for the adoption of new technologies and disruptive innovations, firms need workers with specific and new skill sets. This often involves the need to hire new workers, and firms are more willing to do that if they can lay off these workers again in case such an innovation is not successful, which is often the case. Experimentation plays a crucial role in disruptive innovations. Therefore, job transitions (whether through a period of short unemployment or direct job-to-job transitions) are an engine of growth during times of significant technological change.

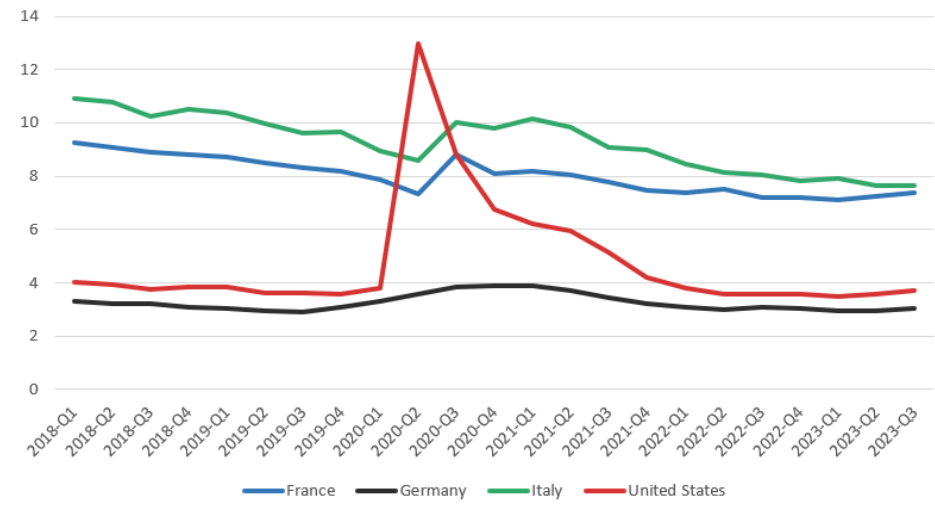
The different labour market policies in the US and Europe became very apparent during the Covid crisis. Chart 3 shows the unemployment rates in the US and in Italy, France and Germany from 2018 to 2023. In response to the crisis, US firms laid off workers, resulting in significant job losses and a high unemployment rate, followed

by substantial hiring after the crisis. European countries, by contrast, largely relied on policies that maintain worker-firm matches, particularly short-time work. Therefore, the unemployment rate barely changed in Europe.

Chart 3

Unemployment rate

(2018 – 2023, quarterly)



Source: OECD (2025), unemployment rate

Which set of policies is more conducive to growth? Hershbein and Kahn (2018) demonstrate that US firms in regions hit hardest by the Great Recession used the recession-induced layoffs to increase the skill demands of new hires, and subsequently also invested more in new technologies. By contrast, policies in European countries protect firm-specific human capital. While this is beneficial in stable times, it is not the optimal policy during periods of major structural change, like the one we live in. In ongoing work with Chiara Lacava (2025), we analyse the firing ban imposed by Italy from March 2020 to October 2021 as a consequence of the Covid crisis. We show that firms less affected by the firing ban experienced more separations and more hires, and used these hires to upskill their workforce, just as shown by the evidence in Hershbein and Kahn (2018). Differences in labour market institutions could thus explain the growing productivity gap between the US and the Euro Area during the Great Recession and the Covid recession shown in Chart 1. The European policies, focused on preserving matches, make it more difficult for firms to use recessions for a restructuring of their workforce.

3 Challenges faced by European labour markets

In this section, I describe the two major challenges faced by European labour markets nowadays: the lack of labour market dynamism documented in Benjamin Schoefer's paper, and a significant decrease in labour supply. Both likely affect each other, as I argue in the end of this section.

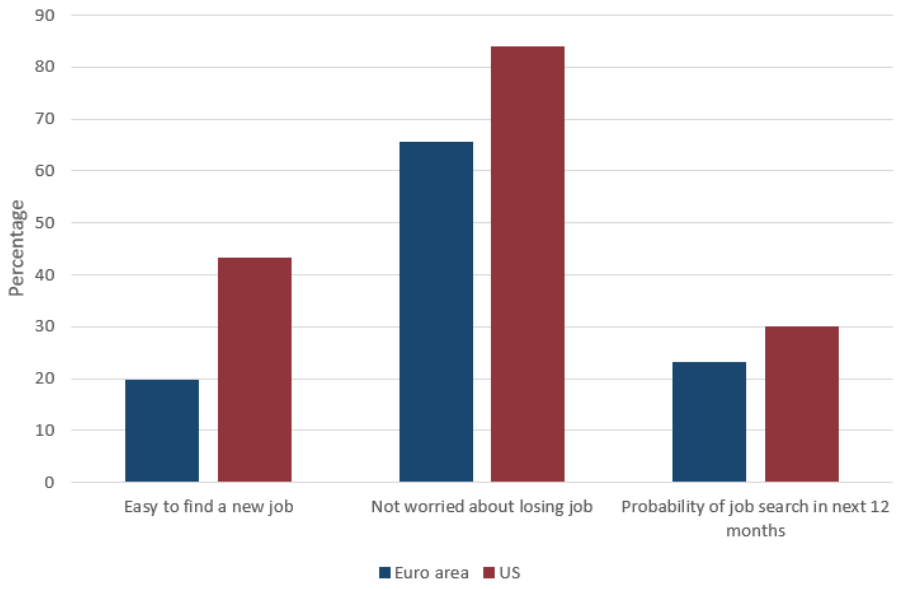
3.1 Lack of labour market dynamism: institutional and cultural aspects

Next to the stagnantly high employment protection index of the OECD for European countries documented in the paper, survey evidence also indicates a lack of labour market dynamism in Europe compared to the US. A look at the International Social Survey Programme – a cross-national collaboration conducting annual surveys on diverse topics relevant to social sciences – provides insights into key differences between the US and the Euro Area regarding people's attitudes towards labour markets. Chart 4 summarizes the survey results, revealing that Americans, compared to respondents in the Euro Area, perceive it as easier to find a new, well-paid job, worry less about job loss, and are more likely to engage in on-the-job search. These findings align with more flexible labour market institutions that facilitate finding a job when unemployed. However, they may also reflect a different and more dynamic attitude towards labour markets among Americans.

Chart 1

Ease of finding a new job, worry about job loss, and job search probability

(Percentage positive answers)



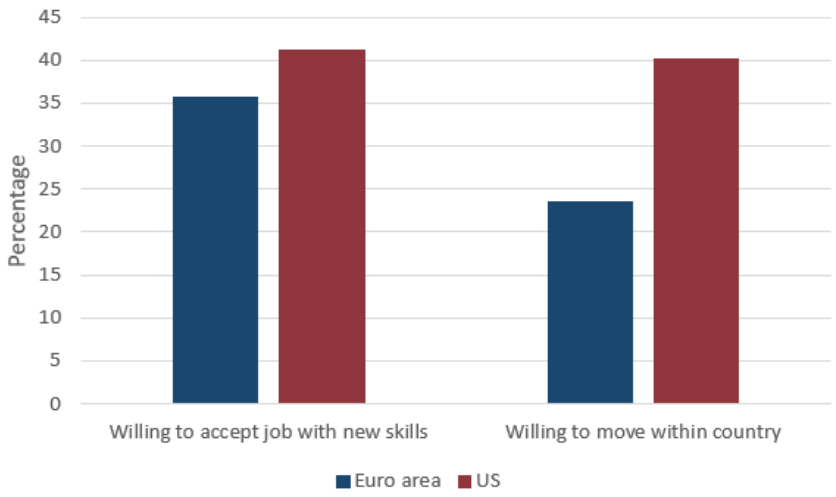
Source: ISSP Research Group (2017)

This possible difference in attitudes is further highlighted in the survey responses shown in Chart 5. Americans are more likely to state that, upon unemployment, they would be willing to accept a job that requires new skills, and to relocate within the country, which is a particularly remarkable given the much larger geographical distances involved compared to those in European countries.

Chart 5

Willingness to accept job with new skills and to move within country

(Percentage positive answers)



Source: ISSP Research Group (2017)

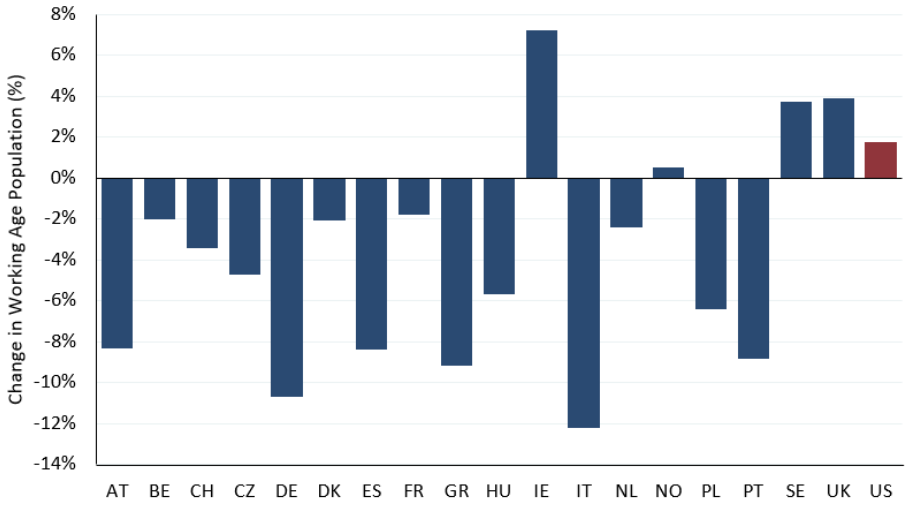
It is impossible to disentangle institutions from culture as causes of these differences based on survey data alone. In fact, institutions affect attitudes, and thus living under more vs. less flexible labour market institutions for decades likely affected attitudes (see Fuchs-Schündeln and Alesina, 2007). Therefore I would caution that, even with European reforms towards more labour market flexibility, it might take some time to achieve the same level of labour market fluidity as observed in the US.

3.2 Decreasing labour supply

In the next decade, European countries will face increasing labour shortages due to decreasing labour supply. First, the number of working-age people will shrink in many European countries over the next decade due to the retirement of the baby boomer generation. UN predictions, as shown in Chart 6, indicate an expected decrease of more than 10% in Germany and Italy. Secondly, hours worked per employed person have decreased significantly in Europe. Chart 7 illustrates the substantial reduction in working hours per employed person over the past 25 years. While at the same time employment rates increased, this increase was not large enough in most countries to overcome the decrease in hours worked per employed person, resulting in an overall decrease in hours worked per person (Bick, Blandin, and Fuchs-Schündeln, 2022). This trend thus contributes to the labour shortage on top of the demographic development.

Chart 6

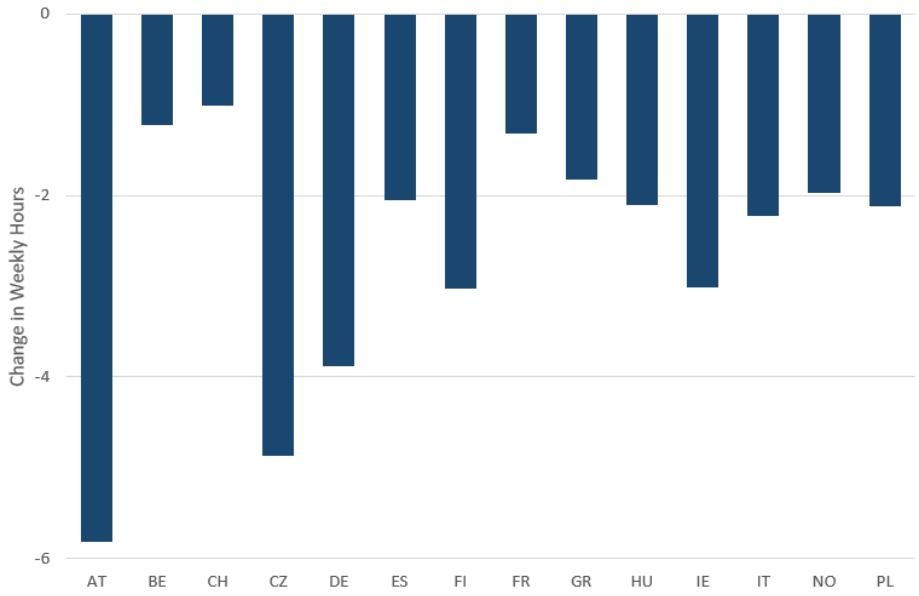
Predicted percentage change in working age (15-64) population, 2024-2035



Source: United Nations, Department of Economic and Social Affairs, Population Division (2024)

Chart 7

Change in weekly hours worked per employed person, 1997/99-2022/23



Source: EU labour force survey, own calculations; see also Bick, Blandin and Fuchs-Schündeln (2022)

3.3 The interplay between labour market dynamism and labour supply

The decrease in labour supply is likely no good news for labour market dynamism. It increases the bargaining power of workers and unions, who favour employment protection. At the same time, labour market dynamism is more important than ever in the context of the challenges Europe faces in the digital transformation and the green transition. Benjamin Schoefer thus rightly points out in his paper that we need creative labour market reforms that encourage job transitions. In addition to the ones mentioned in his paper, e.g. the abolition of seniority rules in employment protection, one potential policy reform could be the establishment of a dual system of employment protection which maintains the current level of protection for low income earners, but reduces protection for high income earners. High income earners can more easily build up precautionary savings to self-insure against income risk, and they are the ones who occupy the jobs in which experimentation with new technologies is crucial, such as engineers and programmers.

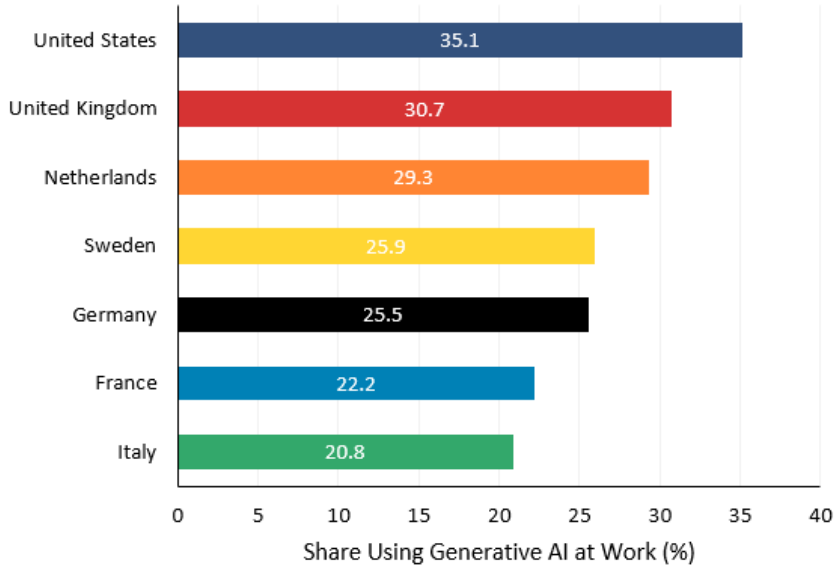
4 Labour market fluidity and technology adoption: the case of AI

How are labour market fluidity and technology adoption related in the case of artificial intelligence, arguably one of the most important new technologies of our days? The paper presents cross-country evidence that links the adoption of Information and Communication Technology (ICT) in the 1990s to employment protection, based on the work by Samaniego (2006). Adoption of ICT in the 1990s was lower in countries with more employment protection. How does this correlation look like in the case of AI adoption? We (Bick et al., 2025) just fielded an internationally comparable and representative survey on the use of AI in the US and six European countries in May and June of 2025. Initial results can be seen in Chart 8. In the US, 35% of workers report using AI at work. This percentage is lower in all European countries. In Germany, for example, it is just 26%; in France and Italy only 22% and 21%.

Chart 8

Share of people using generative AI at work

(May/June 2025)



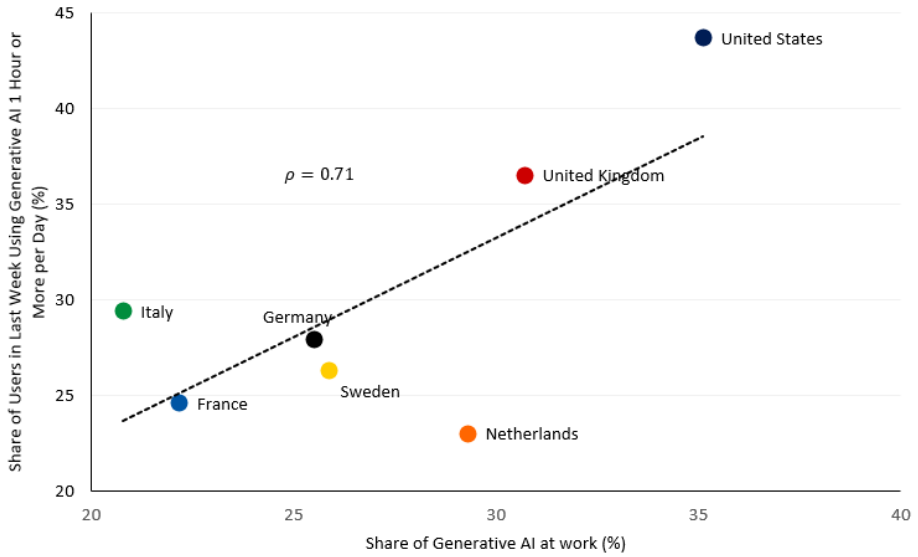
Source: Bick et al. (2025)

Europe is not only lagging behind in the adoption of AI in the workplace at the extensive margin, but also at the intensive margin. Chart 9 shows on the x-axis the same data as Chart 8, namely the proportion of people using AI at work. The y-axis shows the proportion of people using AI for more than one hour per day, conditional on using any AI. European countries lag behind in both dimensions.

Chart 9

Share of people using generative AI at work and AI usage intensity at work

(May/June 2025)

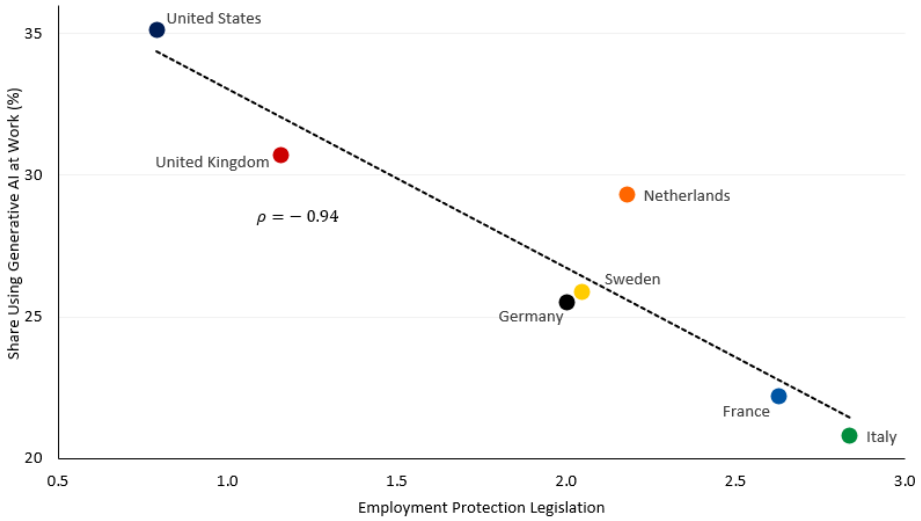


Source: Bick et al. (2025)

Finally, while only relying on seven data points and thus being indicative at best, Chart 10 shows a strikingly strong negative correlation between AI usage at work and employment protection legislation. The latter is measured here as the average of the indices “temporary contracts” and “individual and collective dismissal (regular contracts)” from the OECD’s data on strictness of employment protection. This evidence is very similar to the negative correlation observed in the 1990s between computer adoption and employment protection. Thus, it appears that history may repeat itself with the adoption of AI.

Chart 10

AI usage at work versus employment protection legislation



Sources: Bick et al. (2025)) and OECD (2025), strictness of employment protection, Version 4 (2019)

5 Conclusion

Over the past twenty-five years, the Euro Area has experienced sluggish productivity growth alongside low investment in new technologies. Benjamin Schoefer's paper makes a convincing case that labour market regulation is an important factor behind these phenomena. While surely there are a multitude of causes, including the lack of a European capital market union, innovations require flexible labour markets. A lack of labour market dynamism might not have been an important impediment to growth in times of gradual innovations, but very likely inhibits disruptive innovations, which are crucial for growth in our times of major structural changes.

The implications of these findings vary depending on the target audience. For policy makers, deregulating labour markets to facilitate job transitions and promoting continuous learning is crucial. For central bankers, I would caution that there is no easy remedy for Europe's low potential growth and that decreasing labour supply could generate upward pressure on inflation. Finally, I encourage academics to conduct more causal analyses on the role of labour market institutions for innovation and growth.

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