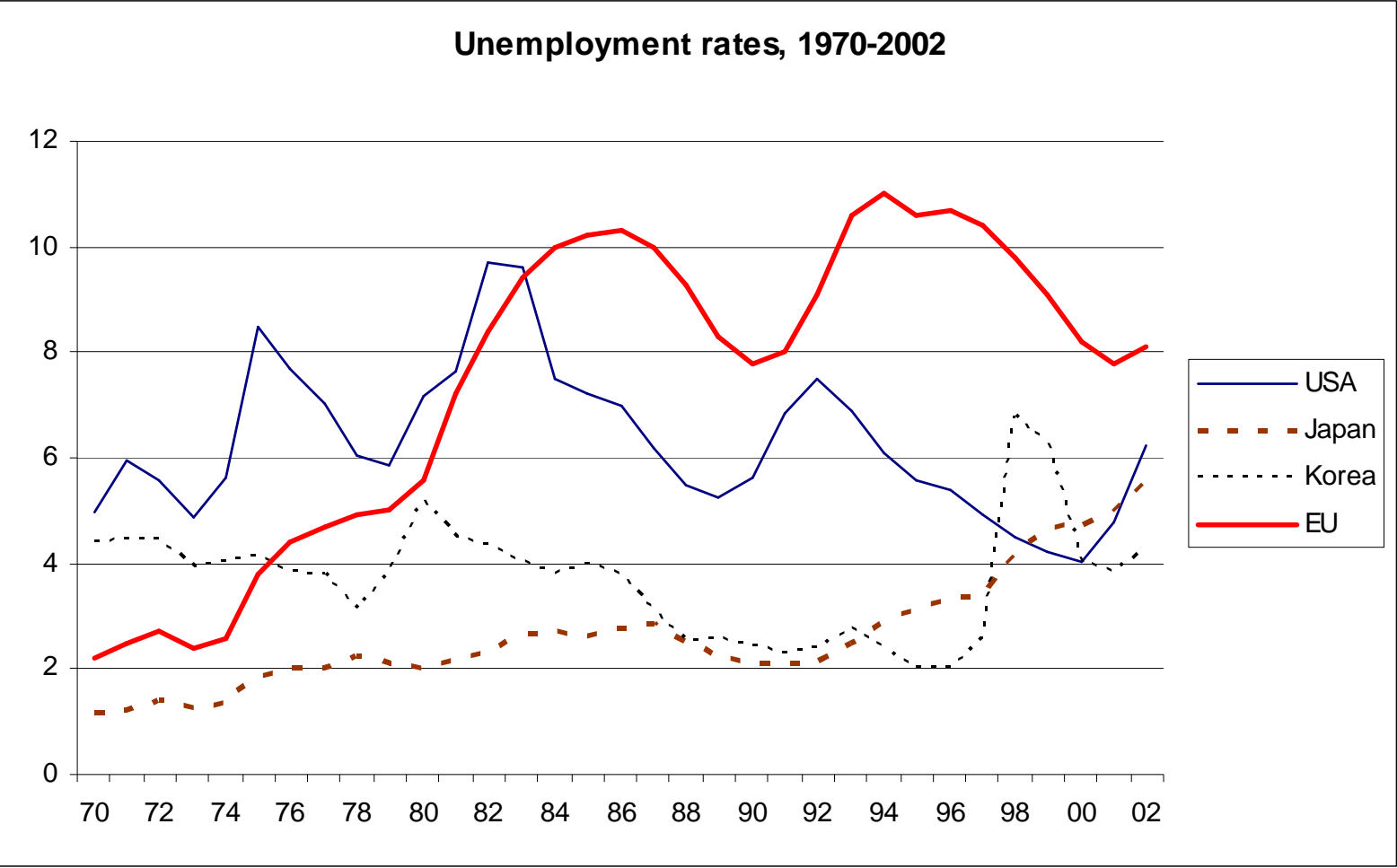


CAUSES OF UNEMPLOYMENT IN EUROPEAN COUNTRIES

Blanchard, 2006; Adnett ch.7.4



Source: OECD data

Two models to explain EU unemployment

- Euroclerosis: due to labour market rigidities the natural (equilibrium) unemployment rate rises
- Hysteresis: unemployment increases due to demand/supply shocks (i.e. technological shocks which shift labour demand from the low to the high skilled; or macroeconomic shocks due to restrictive macro policies). With hysteresis there is unemployment persistence which does not consent the unemployment to decline, even when the economic conditions improve.

CAUSES OF HIGH UNEMPLOYMENT IN EUROPEAN COUNTRIES/ 1

Why did unemployment rise more in Europe than in other countries and persisted at high levels since the first oil shock and up to the early nineties? How much the unemployment rise was due:

- ✓ to greater adverse effects of shocks or
- ✓ to European institutions, bad equipped to deal with shock and rapidly adjust to changing economic conditions?

No single causes, but interaction of negative shocks and institutions:

- negative macroeconomic shocks:
 - worsening of terms of trade
 - restrictive macroeconomic policies to reduce inflation
 - technology
 - international competition
- persistence and influence of past shocks due to institutions:
 - wage bargaining,
 - employment protection,
 - barriers to labour mobility
 - taxation on employment
 - UB

CAUSES OF THE HIGH UNEMPLOYMENT IN EUROPEAN COUNTRIES /2

Initial shocks had more adverse effects on EU labour markets due to *real wage rigidity* which produced higher unemployment costs for a given reduction in inflation.

Initial shocks:

- ✓ increases in oil prices,
- ✓ worsening of terms of trade,
- ✓ slowing down of productivity,
- ✓ shift of labour demand from low skilled to high skilled due to technological progress

Determinants of structural unemployment in the EU

Higher real wage rigidity due to *institutional features*: wage setting mechanisms, employment protection and more generous UB.

Labour market institutions:

- negative effects on U of strong unions and unemployment benefits (less harmful with coordination and active job search requirements)
- effects of employment protection on composition of U (more long term U, less short term)
- ambiguous effect of labour taxes (but negative effects of mix of high minimum wages for young people and high pay-roll taxes)

The real wage (especially the relative wage of the low skilled) did not decline in most EU countries despite the decline in the relative demand of low skilled labour.

Results: in the EU increase in unemployment; in the US increase in wage differentials and inequality

Hysteresis

In addition the *propagation mechanism* was longer in EU countries again due to *institutional features* and lead to long term unemployment and capital decumulation (which further reduced labour demand).

Unemployment persistence is due to the increase in the number of the *long term unemployed*, which do not compete for jobs and do not pressure for real wage reductions.

Unemployment persistence may be due to hiring and firing costs and wage setting conditions which segmentate the labour market and reduce the power of outsiders to compete for jobs:

- **Hiring and firing costs** induce firms to reduce hirings and keep out of employment for a long time those looking for a job
- **Inside membership dynamics:** insiders bargaining power increases and reduces the employment probabilities of outsiders
- The outsiders (especially the *long term unemployed*) lose skills and are discouraged in searching for jobs and do not compete for jobs even when conditions improve (the WS curve does not shift downward).

Unions and collective bargaining

	Density \1	Coverage \2	Centralisation \3
Francia	9,1	95,0	2,0
Germania	29,0	92,0	2,0
Spagna	21,1	78,0	2,0
Italia	23,7	82,0	2,0
Stati Uniti	14,3	18,0	1,0
Giappone	24,0	21,0	1,0
Unione Europea	43,1	82,3	1,9

\1 %workers belonging to unions

\2 % workers whose wage is collectively bargained

\3 centralisation level of bargaining. 1 at the firm level, 3 at the national level

Source: OCSE, 1999

Rigidity indexes of employment protection regulation

	Standard employment		Temporary employment		Total index	
	'80s	'90s	Anni '80	Anni '90	Anni '80	Anni '90
France	2,3	2,3	3,1	3,6	2,7	3
Germany	2,7	2,8	3,8	2,3	3,2	2,5
Spain	3,9	2,6	3,5	3,5	3,7	3,1
Italy	2,8	2,8	5,4	3,8	4,1	3,3
Japan	2,7	2,7	...	2,1	...	2,4
USA	0,2	0,2	0,3	0,3	0,2	0,2
EU	2,5	2,3	2,9	2,2	2,7	2,3

\1 index increases at the increase in rigidity from 0 to 6

OECD, 1999

Taxation on labour

	Social security Contributions \1	Tax wedge \2
Francia	39	63,8
Germania	23	53
Spagna	33	54,2
Italia	40,2	62,9
Stati Uniti	20,9	43,8
Giappone	16,5	36,3
Unione Europea \3	34	58

\1 includes pension, social and unemployment insurance contributions

\2 includes social security contributions, income taxation and consumption taxation

\3 average of ITA, SP,FR and GER

Source: Nickell e Layard, 1999

Wages and employment

variation in relative
wages for low skilled
(1980-1995, %)

relative unemployment rates
low skilled / high skilled
(1970s) (1990s)

USA	-13	3.5	3.5
France	3	1.5	2.9
Germany	8	2.1	2.6
Italy	1	0.4	1.1
UK	-14	3.1	5.3

Table 11
NAIRU estimates, 1990 and 1999

	1990	1999
Austria	4.6	4.9
Belgium	8.4	8.2
Denmark	6.9	6.3
Finland	5.6	9
France	9.3	9.5
Germany	5.3	6.9
Greece	8.4	9.5
Ireland	14.1	7.1
Italy	9.1	10.4
Netherlands	7.5	4.7
Portugal	4.8	3.9
Spain	17.4	15.1
Sweden	3.8	5.8
United Kingdom	8.6	7

Source: Turner et al. (2001), table 2, p. 192

Policy implications

- Protect workers, not jobs
- Couple UB with pressure on the unemployed to take jobs and active measures to help them finding jobs
- Ensure that employment protection internalise social costs, but does not inhibit job creation and labour reallocation
- Reduce the costs of low skilled labour and support labour participation through make work pay policies, rather than minimum wages
- Increase competition in the product market
- Reduce barriers to labour mobility

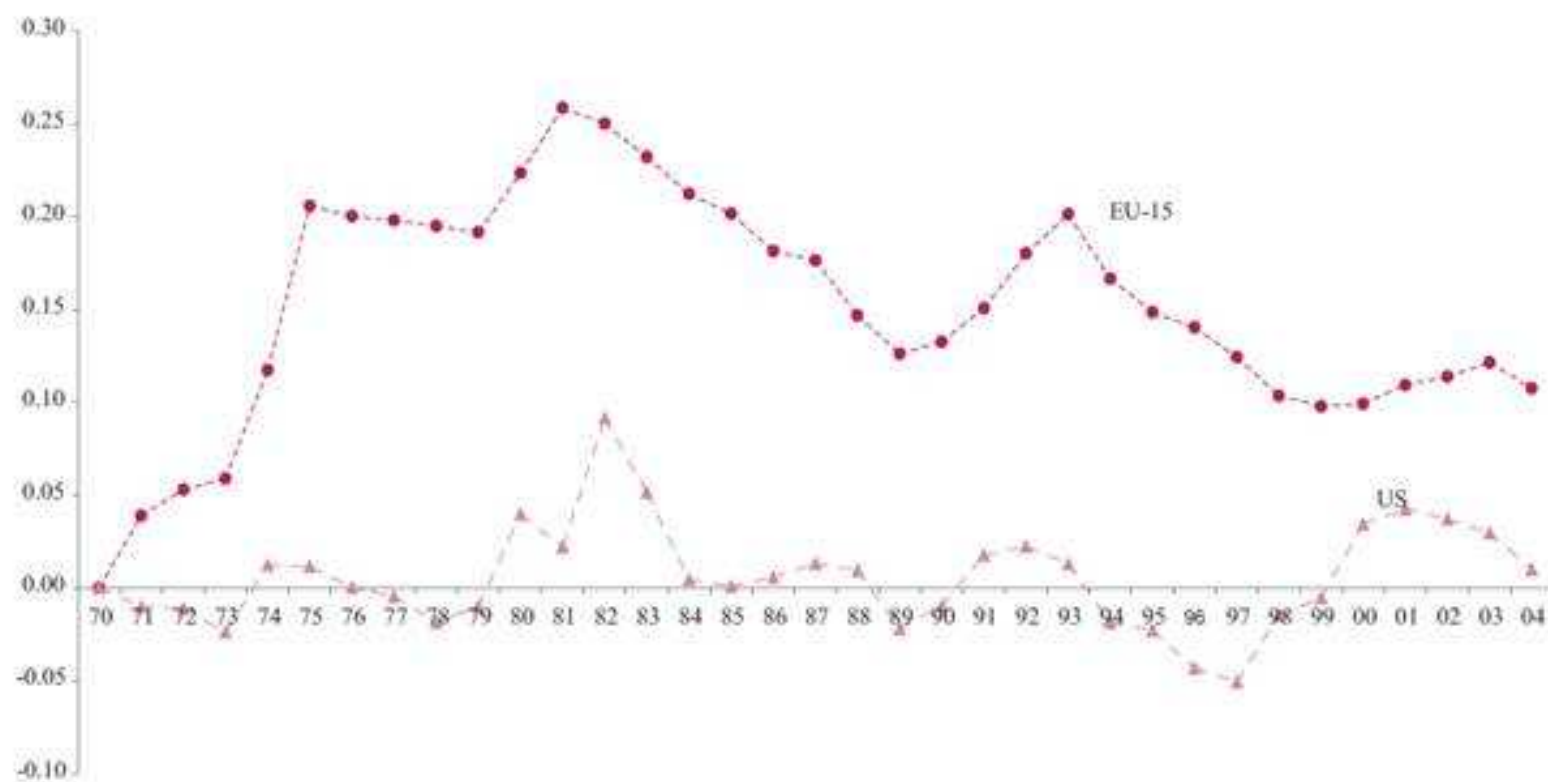
Improvements in EU NAIRU in the late nineties

- In the late nineties the NAIRU started to decline in European Countries.
- The recent improvement in the NAIRU and employment rates appear to be due to:
 - Increasing openness of EU economy
 - wage moderation,
 - increase in flexible contracts (especially part-time and temporary contracts),
 - improvement in skill structure of labour supply,
 - increases in participation rates (among women).

These factors have increased the employment content of GDP growth and shifted the Phillips curve to the left.

- Part of the improvement in labour market conditions may be due to EMU, which imposed a greater discipline to wage bargaining and supported wage moderation.
- Also the greater competition due to European Enlargement and globalisation imposed wage moderation and labour market/product market structural reforms

Chart 73 – Real wage gap/pressure indicator (1970=0)



Source: DG ECFIN, Ameco and own calculations.

EU unemployment and the EMU/1

POSITIVE EFFECTS

(Dunthine & Hunt, 1994; Bean, 1998; Burda, 1999)

- More transparency & competition
- Increased pressure for reforms of product and labour markets
- More discipline on wage setters and national policy makers

NEGATIVE EFFECTS

(Calmfors, 1998; Sibert & Sutherland, 1997; Cukierman & Lippi, 1999)

- Risk of “wage catching up” process
- Free-rider behaviour of unions and national authorities
- Social conflict following structural reforms: less tools to support national and local economic conditions and compensate for adverse shocks. Less options to accompany labour market reforms with expansive macroeconomic policies at the national level.

EU ENLARGEMENT

- EU population increases from 380 to 454 millions (EU 25) and to 485 millions (EU 27)
- In NMS GDP yearly growth rate is on average 4% relative to 2,5% of EU15. Employment rates in EU 15 are higher than in accession countries
- Agriculture large share of employment; wage differential high (4 euros per hour relative to 22); lower gender differences; large territorial differentials (urban vs rural)
- In order to reach the Lisbon target, jobs should increase by 22 millions between 2002 and 2010 in the enlarged Eu.
- Large differences in welfare regimes(even if on average NMS more similar to anglo-saxon model)

Predictions from economic theory

EU enlargement and economic integration of countries with different incomes provide gains for all countries involved due to:

- Increasing competition and trade opportunities (extension of the internal market)
- Increasing factor mobility
- Increasing wage and price flexibility

BUT

The possibility of asymmetrical shocks increases, due to the large structural differences

Benefits and losses could be distributed unevenly across countries and within each country

HENCE

Need of accompanying measures and structural funds, besides coordination of policies and improvement in decision making

Fears

- Deterioration of living standards, wage losses and job displacements if substitution effect prevails especially for low skilled and Southern Europe
- Pressures on labour markets and social cohesion due to mass migration. Especially on bordering areas and on traditional, labour intensive sectors (agriculture and industrial sectors).
- Delocalization of labour intensive productions
- Increase in territorial disparities
- Given large role of agriculture in NMS, no reform of CAP
- Increasing complexity in EU governance
- Convergence will be a very long process and during this process there are costs of integration to be supported: resources to sustain integration will reduce those available for the weaker areas within the EU 15
- Note: same fears as with the accession of Greece, Spain and Portugal.

Estimated impacts

- According to impact studies, the NMS are too small in relation to the EU 15 to induce substantial changes of the trade conditions and capital movements and of wage and employment conditions at the Eu level.
- The main effects should be concentrated in bordering regions (Austria and Germany).
- The increase in migration flows should be of a minor magnitude. Currently immigrants from NMS represent only 0.3% of the Eu workforce, and 80% are located in Austria and Germany. Temporary rather than permanent migration, especially seasonal workers in construction and catering sectors. Migration flows will be reduced with growth and due to ageing population in AC.
- Negative effects on EU workers would be limited to blue collar workers in the industrial and construction sectors and unskilled service workers, however this effect is estimated to be lower than feared, even in Austria and Germany

Policy implications/1

The transition process may be long and costly. There is a need of specific resources and policies to accompany it (EU coordination).

- policies to accomodate structural reforms
- policies to sustain labour mobility and to regulate migratory flows
- policies to support convergence in income per-capita
- policies to improve the governance and decision making

Policy implications/2

Pressure for convergence in national wage and social policies (and thus in unemployment rates) from:

- **More co-ordination and general framework at the EU level** for social and employment policies (mutual recognition and subsidiarity)
- **Economic forces** and the integration process (product market competition and converging prices; multinational firms, capital and labour mobility)
- **Institutional competition** (more convergence in industrial relations systems; less degree of corporatism and centralisation in wage bargaining)

Policies to mitigate the impact of structural adjustment

- *Flexible labour market institutions* allowing wage and employment flexibility, but providing adequate income support schemes and coordination of welfare, migration and employment policies
- *Support competition* in the product markets and shifting NMS production from agriculture to industry and services
- *Support greater investment in education and training*, especially in general skills and secondary education
- Support in *reducing the informal sector* by simplifying regulation , rationalizing public administration and reducing corruption

Policies coping with regional unemployment differentials

Enlargements shocks may be concentrated in specific regions (especially rural). In order to reduce regional imbalances, policies supporting labour mobility are relevant:

- Mobility loans,
- Transportation networks
- Support to commuting flows

Migration policies

- Migration flows should not be relevant, and will be concentrated in bordering areas.
- Migration flows, especially if in the form of crossborder commuting, may have positive effects on hosting countries with problems of excess labour demand and mismatches and of ageing population.
- Limiting migration flows may be negative, because it reduces integration potentials and increase incentives to illegal immigration and black economy.
- Policies to increase general acceptance of labour mobility (student mobility good tool)

Cohesion policies

- **transfer of resources** to the less developed areas of EU in order to reduce development differentials.
- European Structural Funds have a relevant role in cohesion policy after the enlargement

However:

- the budget for structural and labour market policies is still small (most of EU budget still goes to the CAP): Currently EU structural funds account for about 0.5% EU GDP and one third of EU budget (70% goes to Ob.1 regions).
- Necessary to revise Common Agricultural Policy, to increase the budget for structural funds.
- The EC has no political power to make relevant decisions

Macroeconomic policies

- The necessary control of the budget balance should not jeopardize investments in public infrastructure and social expenditure.
- Policies should also stimulate foreign direct investments in accession countries and especially in rural areas