

EU labour market behaviour during the *Great Recession*

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In 2008 and 2009 European economies were subjected to shocks of unprecedented severity. GDP declined in all countries and, in some cases, output losses were the largest recorded at least since the recession of the early 1970s. Because of this unprecedented collapse in world economic activity, many have dubbed this as the *Great Recession*¹. Bearing in mind the size of the shock, the EU unemployment rate increased initially only to a limited extent. This paper provides an analysis of the labour market adjustment in terms of quantities (employment, unemployment, hours worked) and price of labour, whilst at the same time recognising that many uncertainties remain around the short-term outlook.

We assess the labour market response from an international comparative perspective, acknowledging that whilst all countries have been hit by the global financial shock, the size of the labour market adjustment and its composition has been significantly different across countries. This heterogeneity across countries may be due to the size of domestic and external imbalances, as well as to the particular characteristics of the workforce in those industries mostly affected by the crisis.

It is clear that the burden of the recession has not been evenly spread across different socio-economic groups. For example, workers with *weaker* work contracts, the less qualified and less experienced workers have borne the brunt of the current recession. In many countries, job destruction has been more intense in male dominated sectors but the (preliminary) evidence provided suggests that the industry mix of male employment only partially explains these differences. It is the size of the initial imbalances, combined with the prevalence of men in specific sectors, which may have contributed to the differences in the labour market responses during the recession quarters.

Comparisons with previous recessions also reveal that the relative effects of the current recession on men and women are not particularly unusual, despite men having lost jobs in disproportionate numbers - a conclusion also valid for the US. One unique element of the 2008/2009 recession is, however, the increase in the young unemployment rates.

In order to have a better understanding of the elements influencing the labour market response, one needs to examine the upward and downward movements in unemployment driven by inflows into (job destruction) and/or outflows from unemployment (job finding), which respond differently to shocks and to the constraints and incentives created by labour market institutions. Elsby et al (2009) developed a methodology to exploit annual and quarterly Labour Force Survey (LFS) data to measure annual averages of monthly unemployment flows for the OECD countries. We have adapted this methodology by

¹ Strauss-Kahn (2009), "Crisis Management and Policy Coordination: Do We Need a New Global Framework?" Speech given at the Oesterreichische Nationalbank. <http://www.imf.org/external/np/speeches/2009/051509.htm>

exploiting quarterly and monthly LFS data in order to measure quarterly averages of monthly unemployment flows for all the EU27 countries. To the best of our knowledge, this is the first paper to provide a description of inflows and outflows rates during the recession quarters. We also provide an estimate of the flow steady state unemployment rate (i.e. the unemployment rate consistent with balanced inflows into and outflows out of unemployment). When the actual unemployment rate is below the steady state, as now in Europe, there are more inflows into than outflows from unemployment. This in turn implies that the unemployment rate will rise further in the near future, as far as the two flows will balance. A closer look at the individual countries also highlights very heterogeneous patterns in inflows and outflows. For example, both flows increase in the Nordic countries, whilst some countries like Spain and Ireland are experiencing an impressive surge in the inflow rate. The same holds true for the Baltic countries, albeit on a smaller scale, whilst, finally, inflow and outflows do not change much for countries such as Germany and Italy.

The adjustment in the average hours worked was a key factor in limiting the increase in unemployment at the early stage of the recession and the subsequent size of the labour hoarding raises concerns about the labour market response at the early stages of the recovery. We provide evidence of an asymmetric response of employment and unemployment over the cycle, with recessions being characterised by more job destruction than by job creation in the recoveries which followed. On the positive side, compared to the recession of the early 1990s, our analysis suggests that the expected increase in unemployment is similar to that estimated for the recession of the early 1990s but will probably be less persistent over time. This persistence can be influenced by a deterioration of the matching between vacant posts and unemployed people as the average unemployment rate increases. Evidence based on survey data suggests that, so far, in this recession the increase in unemployment rates linked to mismatching is due to a lack of demand for labour rather than an increase in the mismatch between vacant posts and skills. In other words, there have been changes along the Beveridge curve rather than changes of the position of the curve. Yet, the size of adjustment required in certain sectors may imply that sectoral shifts may take time to occur, rendering the skills of workers, especially those formerly employed in industries with non-transferable skills, obsolete. However, estimates based on past evidence suggest that the impact of sectoral reallocation on structural unemployment seems on average small.

The shape of the unemployment response is influenced by the capacity of wages to reflect changes in demand. We have observed that, whilst there has been an adjustment in the compensation per employee, led by the fall in the variable component, this has not been sufficient to avoid the increase in the nominal unit labour costs due to labour hoarding. This type of response may have contributed to stabilising incomes and consumption, but it may also create competitive pressures at the early stage of the recovery if negotiated wages do not incorporate the impact of the recession.

There are extensions to this analysis, which we believe could be of further interest. First, we provided evidence of heterogeneous impact of the crisis on socioeconomic groups and countries. Further work should attempt to quantify, in a multivariate framework, the determinants of this differentiated performance. In doing so, one could take into account the role played by initial institutional and macroeconomic conditions, in particular, as far as the configuration of labour market institutions and various imbalances prevailing before the crisis are concerned, and of workers' socio-demographic characteristics. Second, further work could also try to assess the extent of the stabilisation of employment and unemployment of the measures enacted in response to the crisis.