

Structural unemployment and its determinants in the EU countries

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NON-TECHNICAL SUMMARY

This paper identifies factors driving structural unemployment across 13 EU countries. Its level is determined by institutional and fiscal factors (unemployment benefits, tax rates). Empirically, the level of structural unemployment cannot be observed directly. Instead it has to be estimated. In this paper we use the so-called NAWRU estimate, as produced by Commission services, as our reference measure for structural unemployment.

Our empirical results are close to those reported in other studies. A 1.0 pp. decline in the labour tax wedge is estimated to yield a 0.3 pp. reduction in the NAWRU. A similar decline in the unemployment benefit replacement rate would yield less impact (i.e. broadly half). Active labour market policies and the level of union density also play a role. Results indicate also that while addressing workers' incentives is not to be overlooked, paying attention to the functioning of the wage negotiation framework is particularly important in Europe.

Apart from institutional and fiscal factors we find that persistent demand shocks (i.e. large and long-lasting demand shocks) also have a bearing on the NAWRU. Such shocks are related to crisis episodes (i.e. unwinding of unsustainable developments) and include, for instance, housing boom-bust effects. Those factors are expected to have temporary (though potentially highly persistent) effect on the level of the NAWRU. Occasionally those effects can even be the main drivers of NAWRU developments – e.g. in periods of crises and in times of build-up and unwinding of unsustainable economic positions. Note that distinguishing among all the different types of effects (i.e. structural effects versus non-structural effects) is particularly important when attempting to anticipate future NAWRU developments.

The work presented in this paper has yielded a number of insights on the dynamics of the NAWRU. First, it confirmed that NAWRU developments are related to labour market structural developments. Second, other variables causing persistent demand shock play also a role. Distinguishing between those two types of effects can provide valuable policy insight. In particular, it provides a framework that helps anticipating likely future NAWRU developments. This empirical analysis on the drivers of NAWRU developments also provides a useful tool for policy analysis (e.g. tracking impact of structural reforms) and monitoring (e.g. identifying source of underperformance). However, limitations of the analysis should be borne in mind, namely results can only reflect the information that could be taken into account. Yet, the fact that the empirical analysis is able to account well for the evolution of the NAWRU unambiguously confirms the usefulness of such approaches.

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