



UNIVERSITEIT VAN AMSTERDAM

What Happened to European Mass Unemployment?

Willem F. Duisenberg Lecture

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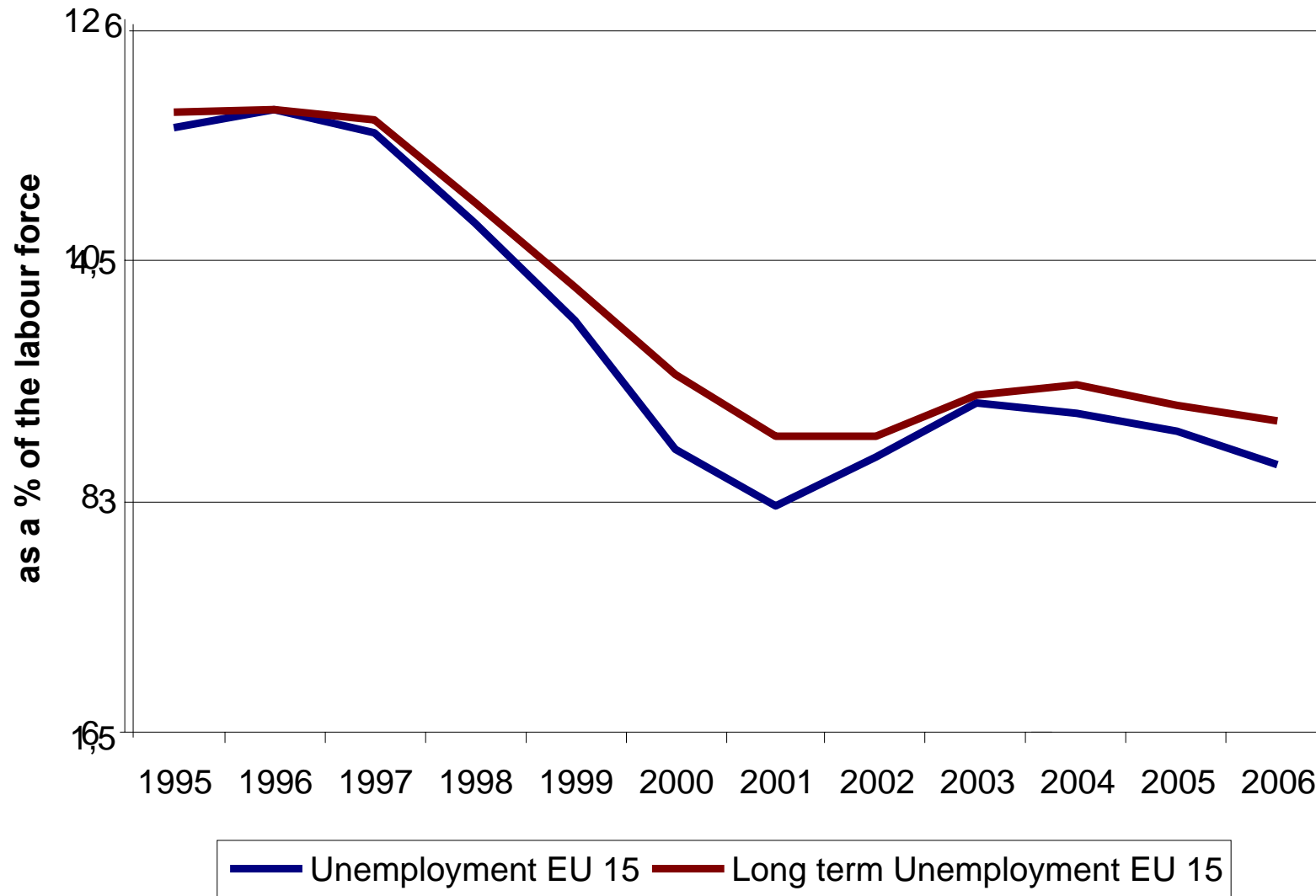
Willem F. Duisenberg Fellowship Stichting



1994 OECD Jobs Study

- “The labour market has become particularly worrying in Europe... (...) in comparatively *inflexible* Europe, *on the other hand*, both relative employment and unemployment rates deteriorated”.
- “The high incidence of long-term unemployment in most EC countries is associated with *low inflow rates into unemployment*. The opposite relationship – low incidence of long-term unemployment and high inflows into unemployment – holds for North America”.

Since then



Outline

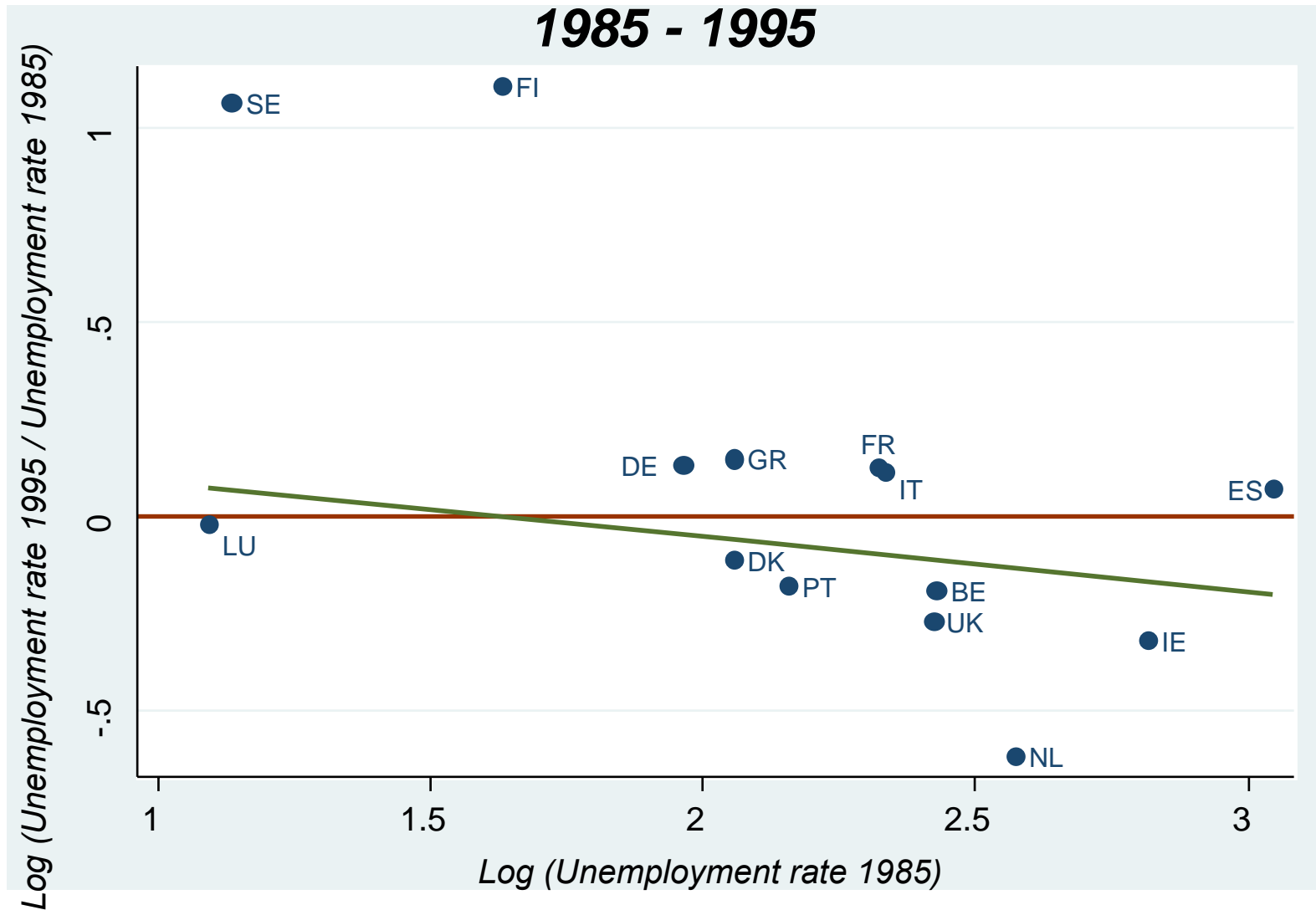
- A European dream... turning into a European nightmare
- Why? A closer look at transitions across labour market states
- Can we “cheat” the employment labour productivity tradeoff?

A European dream

“The Community shall have as its task (...) to promote throughout the Community (...) a high degree of *convergence* of economic performance, a high level of *employment* and of social protection, the raising of the standard of living and quality of life, and economic and *social cohesion* and solidarity among Member States”.

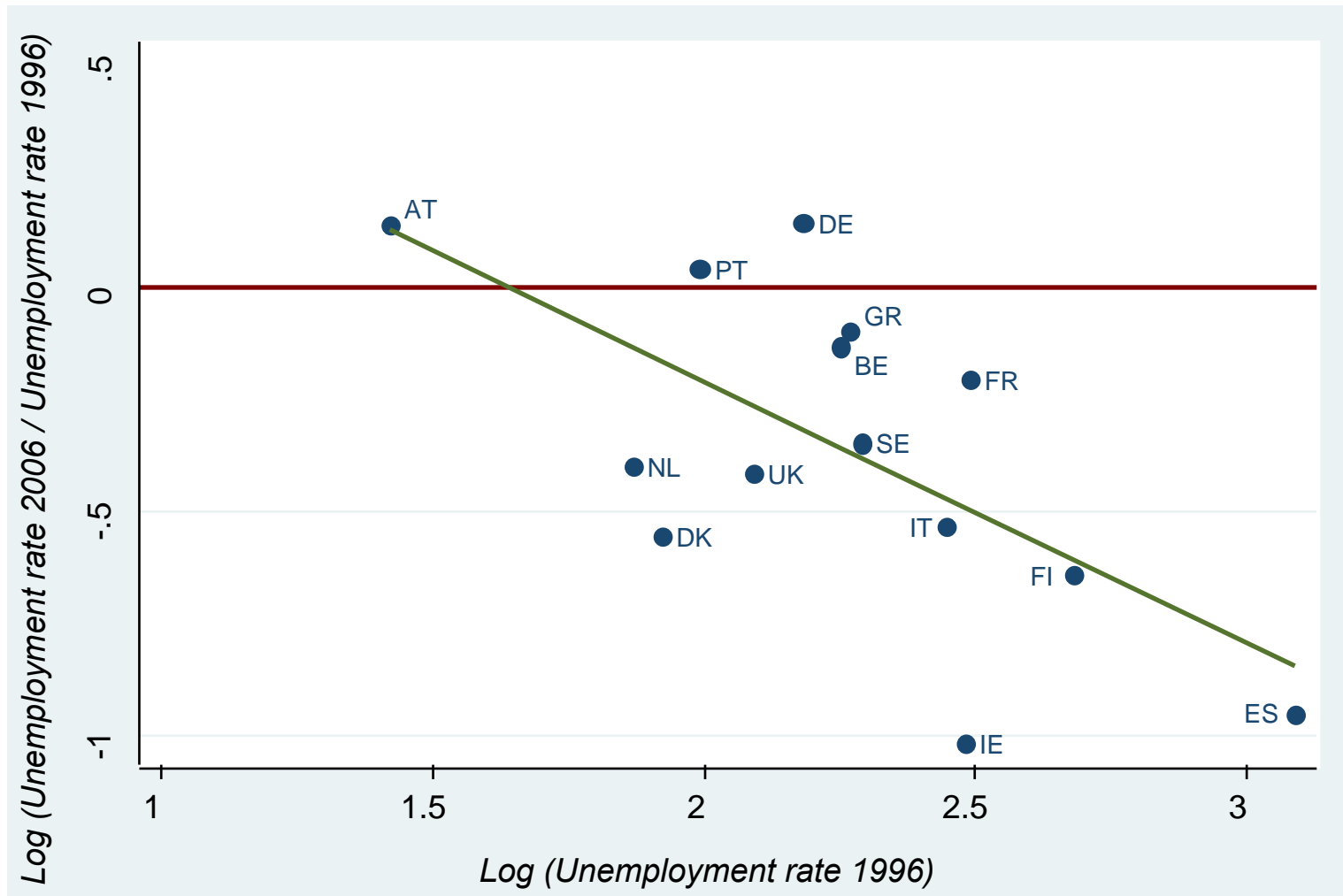
Rome Treaty, March 25, 1957

Convergence: Did the countries with high unemployment experience the strongest decline in unemployment?



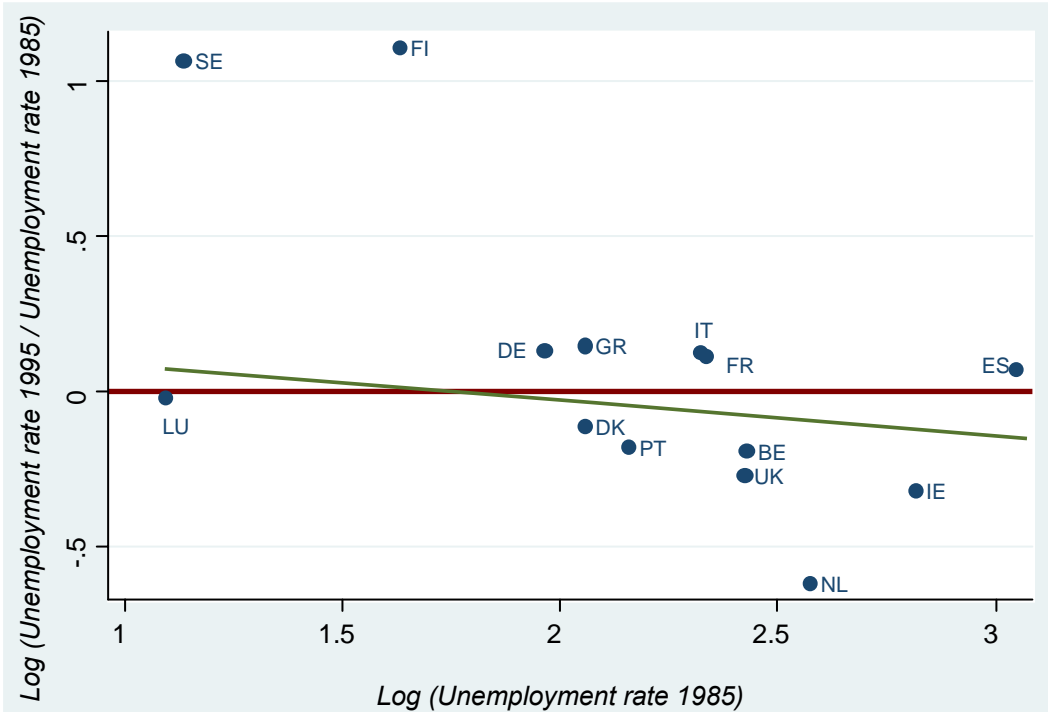
Convergence

1996 - 2006



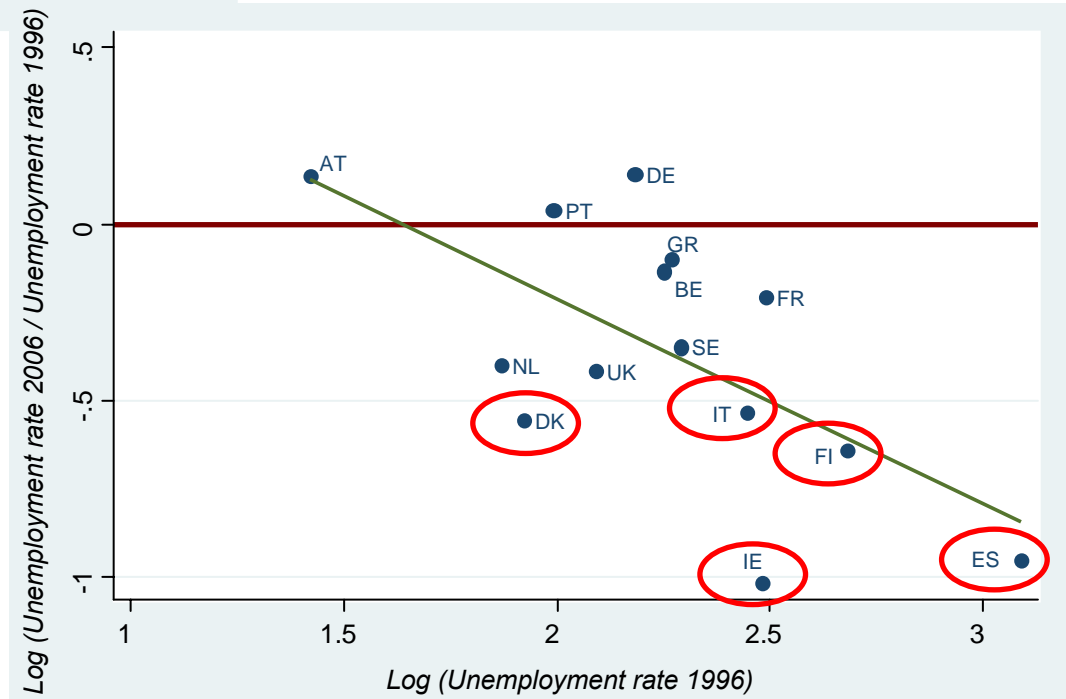
No convergence

1985 - 1995



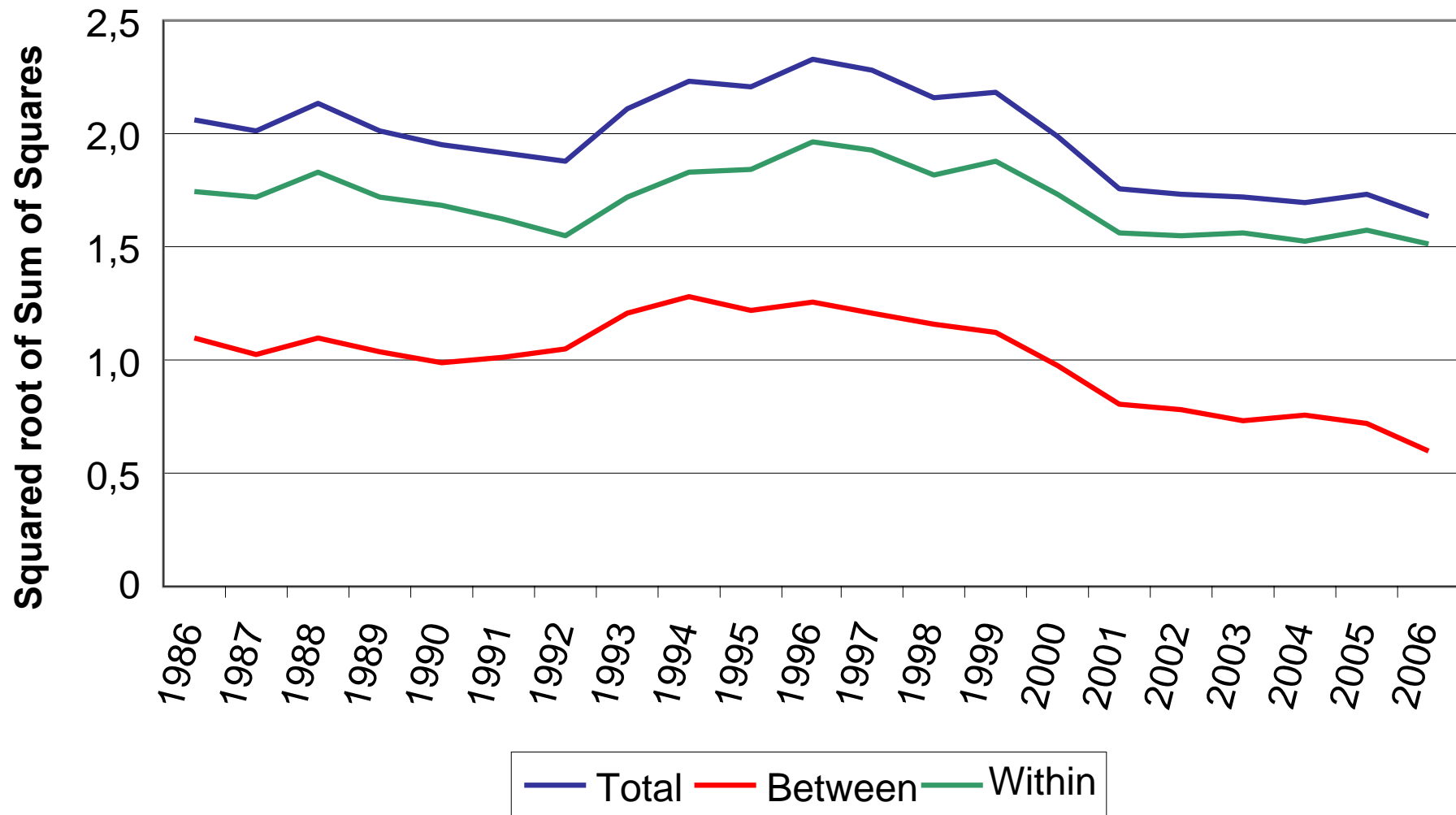
Convergence

1996 - 2006

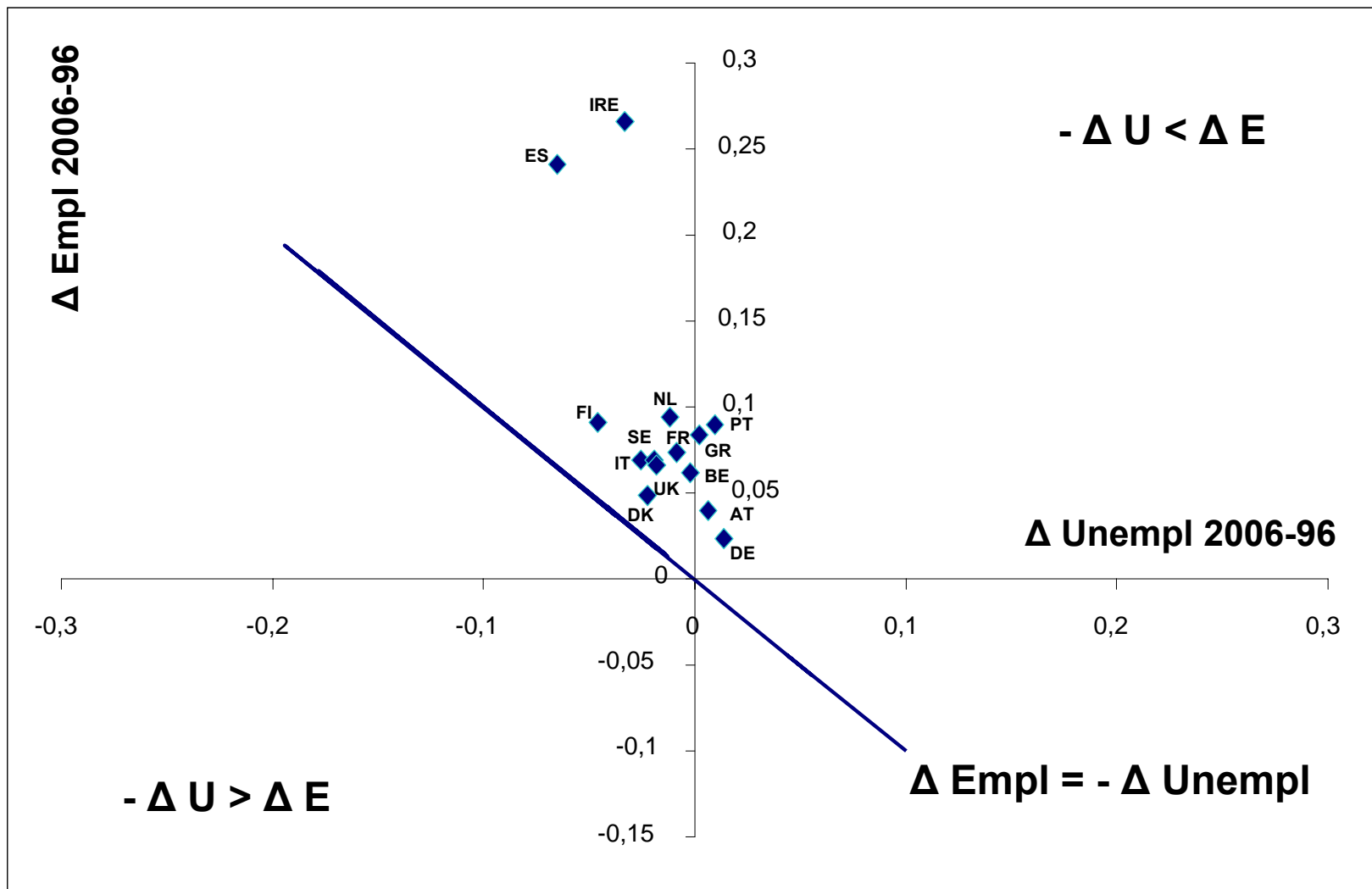


Convergence in unemployment rates also within EU countries since the mid 1990s

(Nuts II regions)

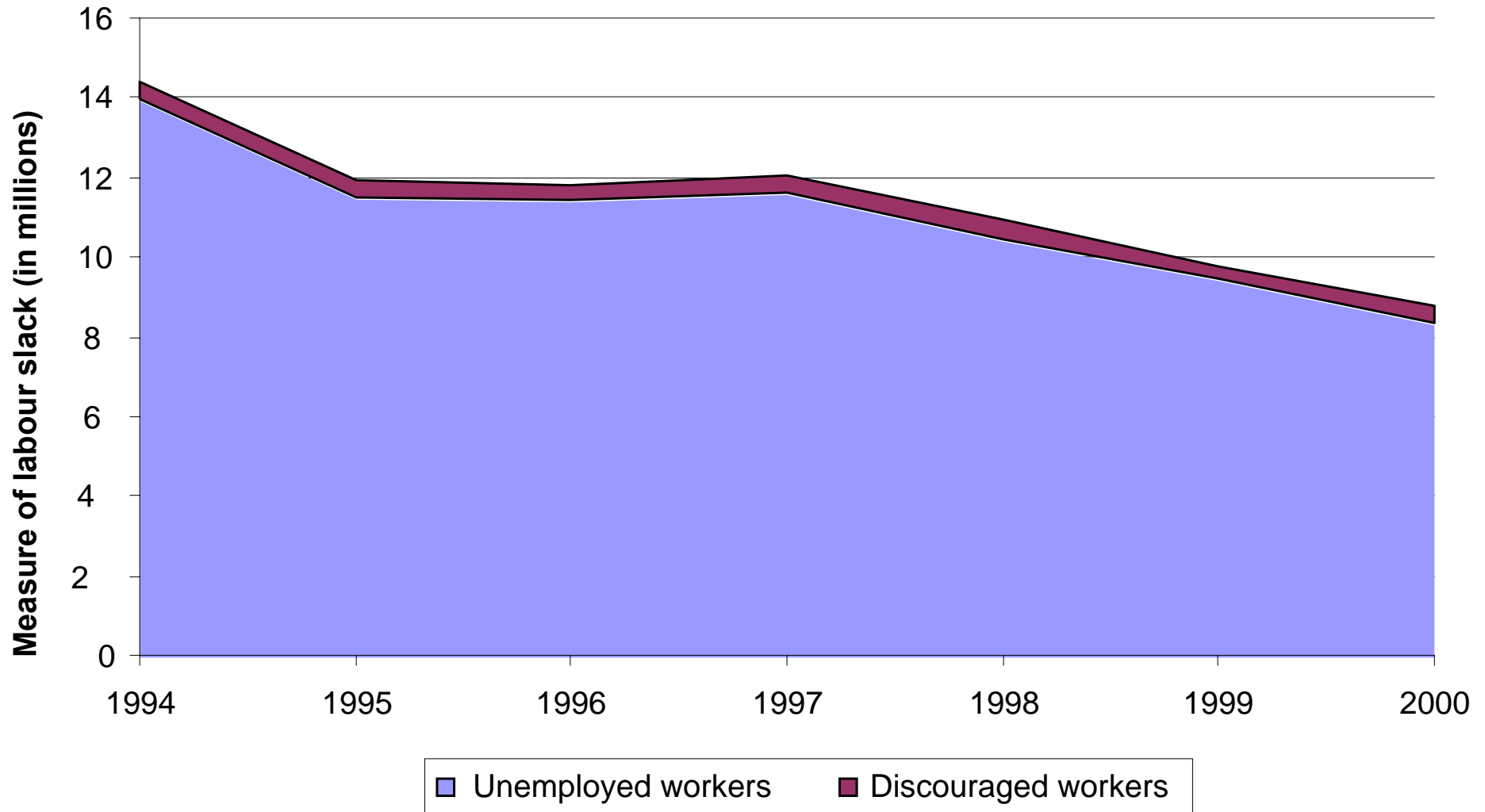


It is not inactivity. It is employment



Unemployment and Employment expressed as a fraction of the working age population

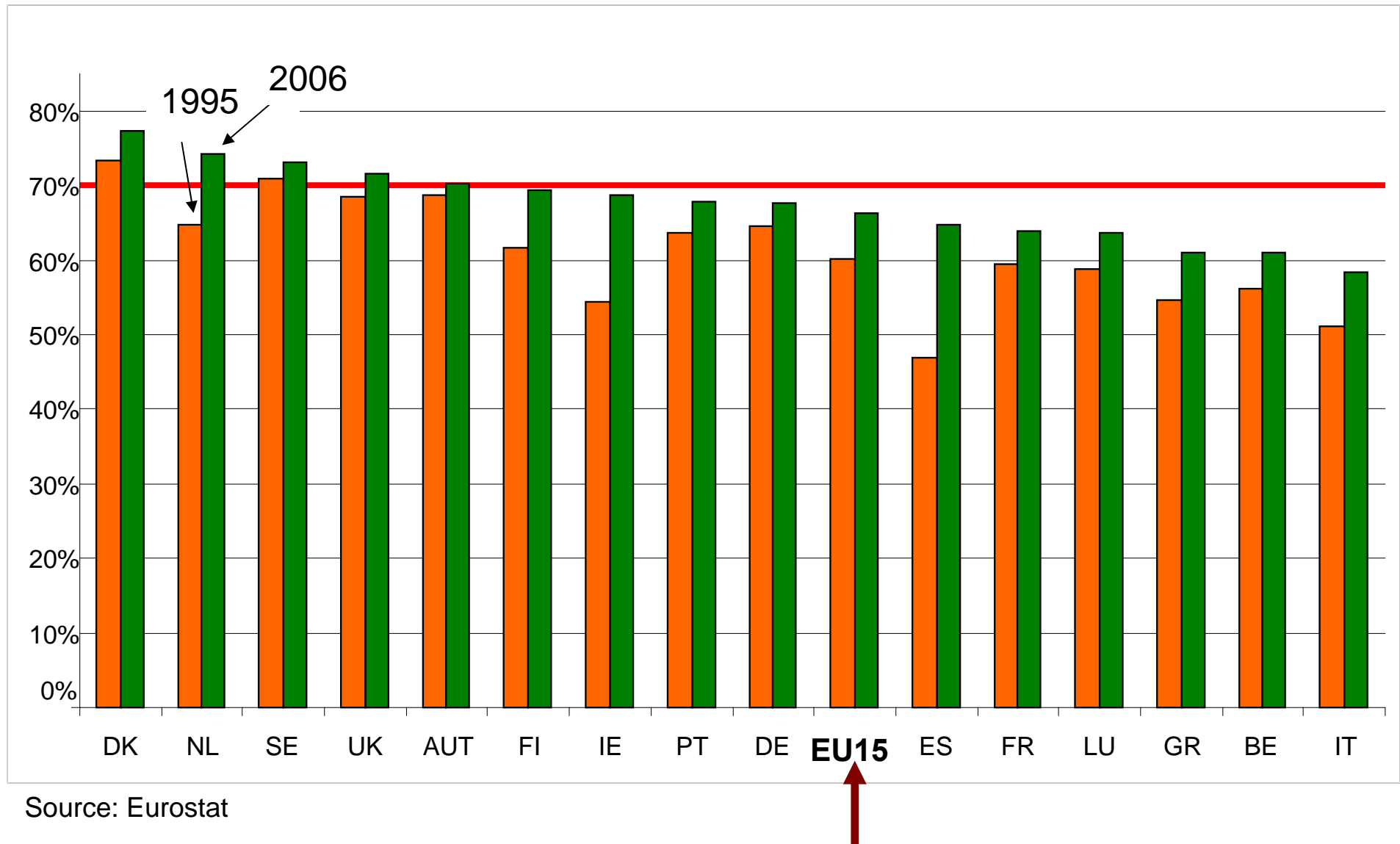
Whatever measure of labour slack we use



EU Countries: DK, BE, FR, IRE, IT, GR, ES, PT.

Lisbon is no longer a mirage

Employment to population rates and the distance from the Lisbon Employment Target



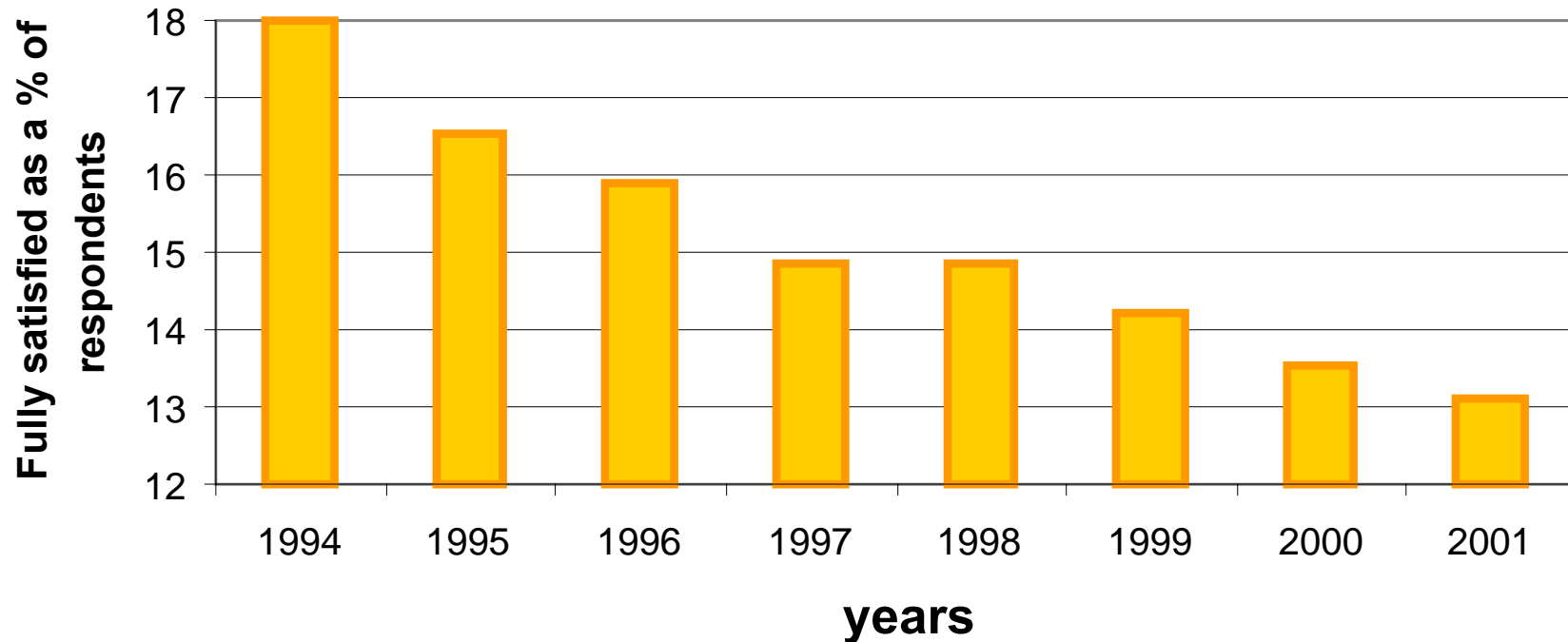
Source: Eurostat

The dream came true?

- Since 1995, the UE15 has 4 millions less people unemployed.
- Decline seen in 11 countries out of 15.
- Associated with 21 millions more jobs.
- Reducing cross-country and within country unemployment differentials.
- Supposedly more “social cohesion”, but...

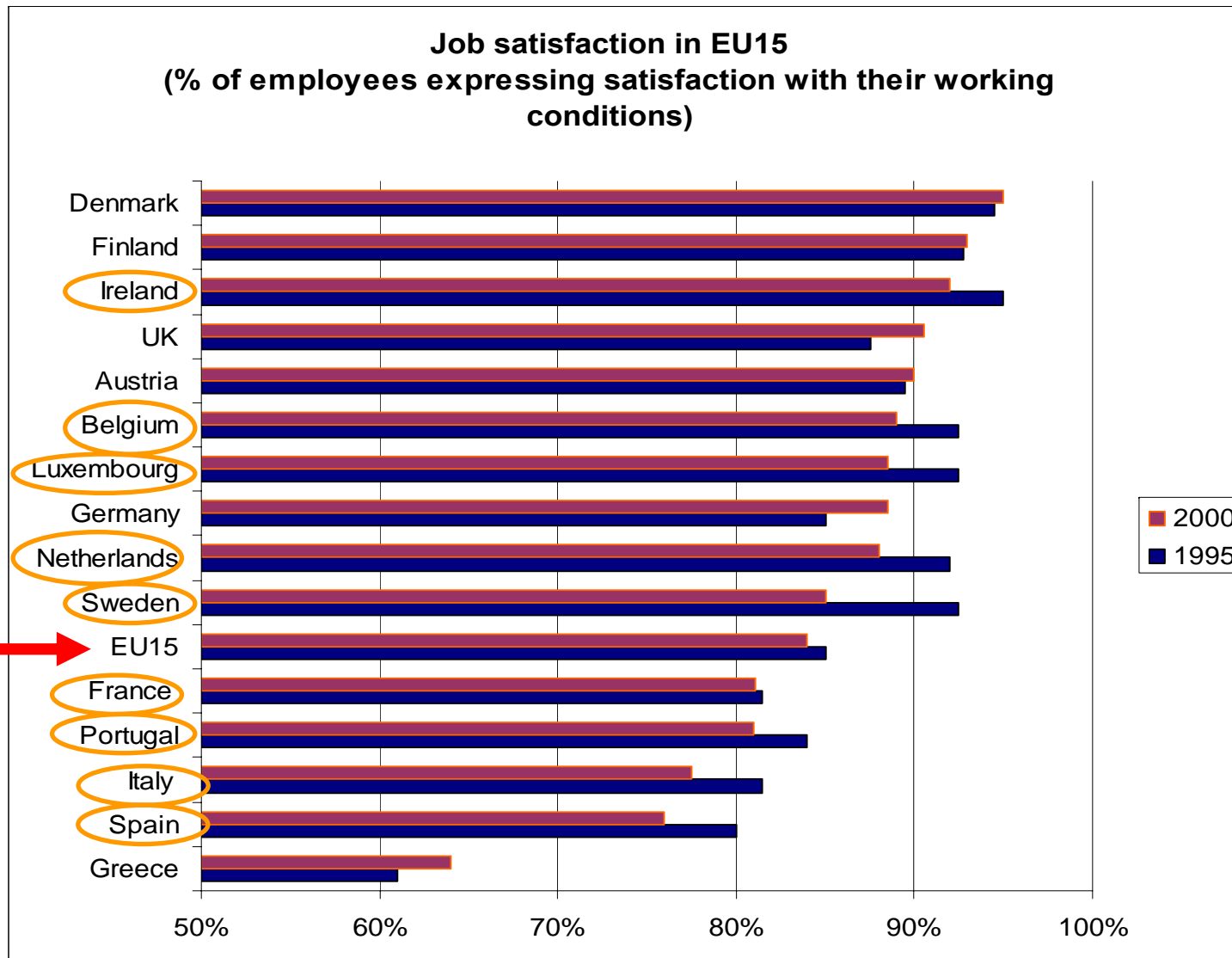
...Europeans are unhappy

Satisfaction with work or main activity in EU10



Source: ECHP

Declining job satisfaction notably in the countries with the strongest unemployment decline

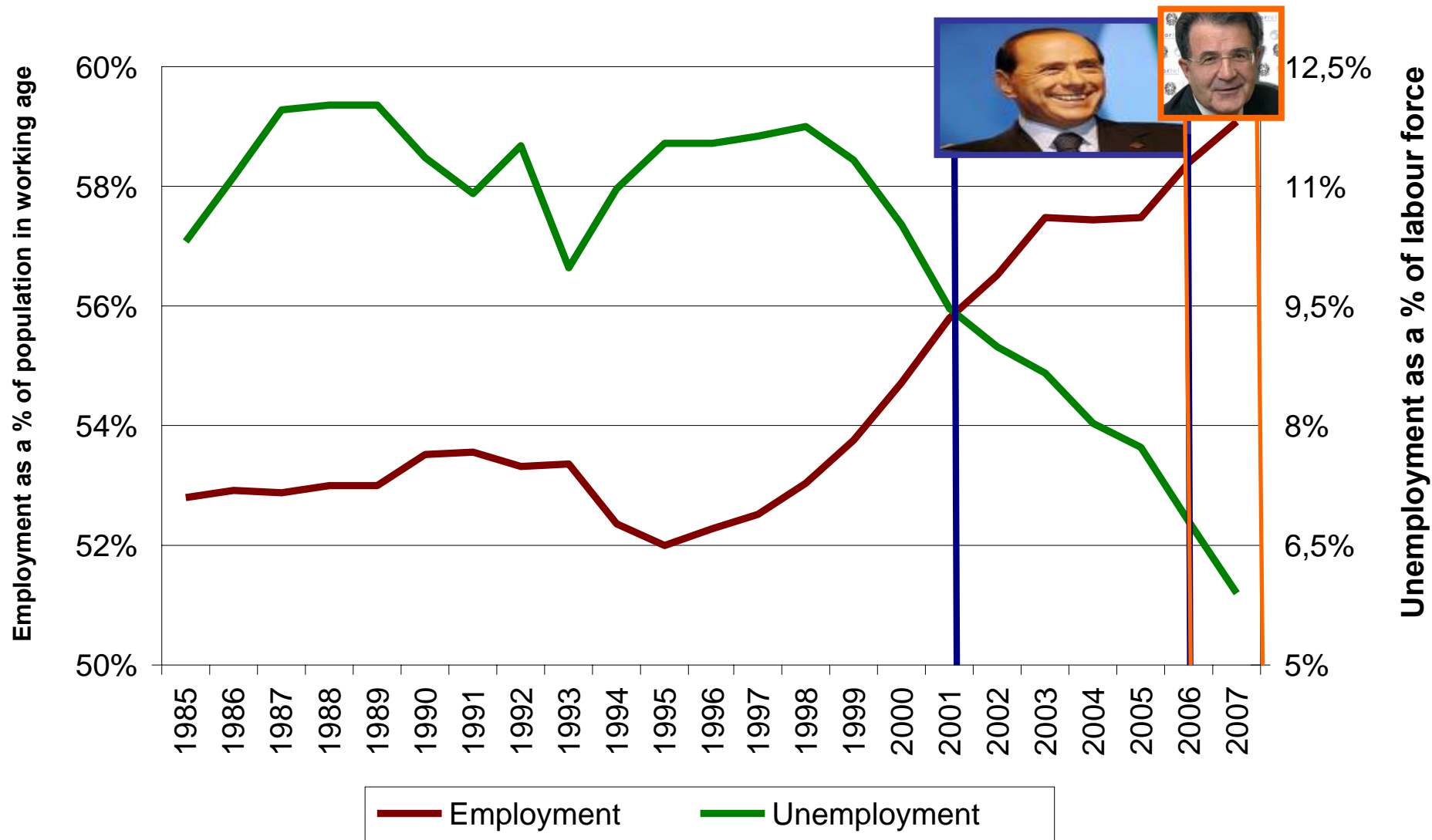


Source: www.eurofund.europa.eu

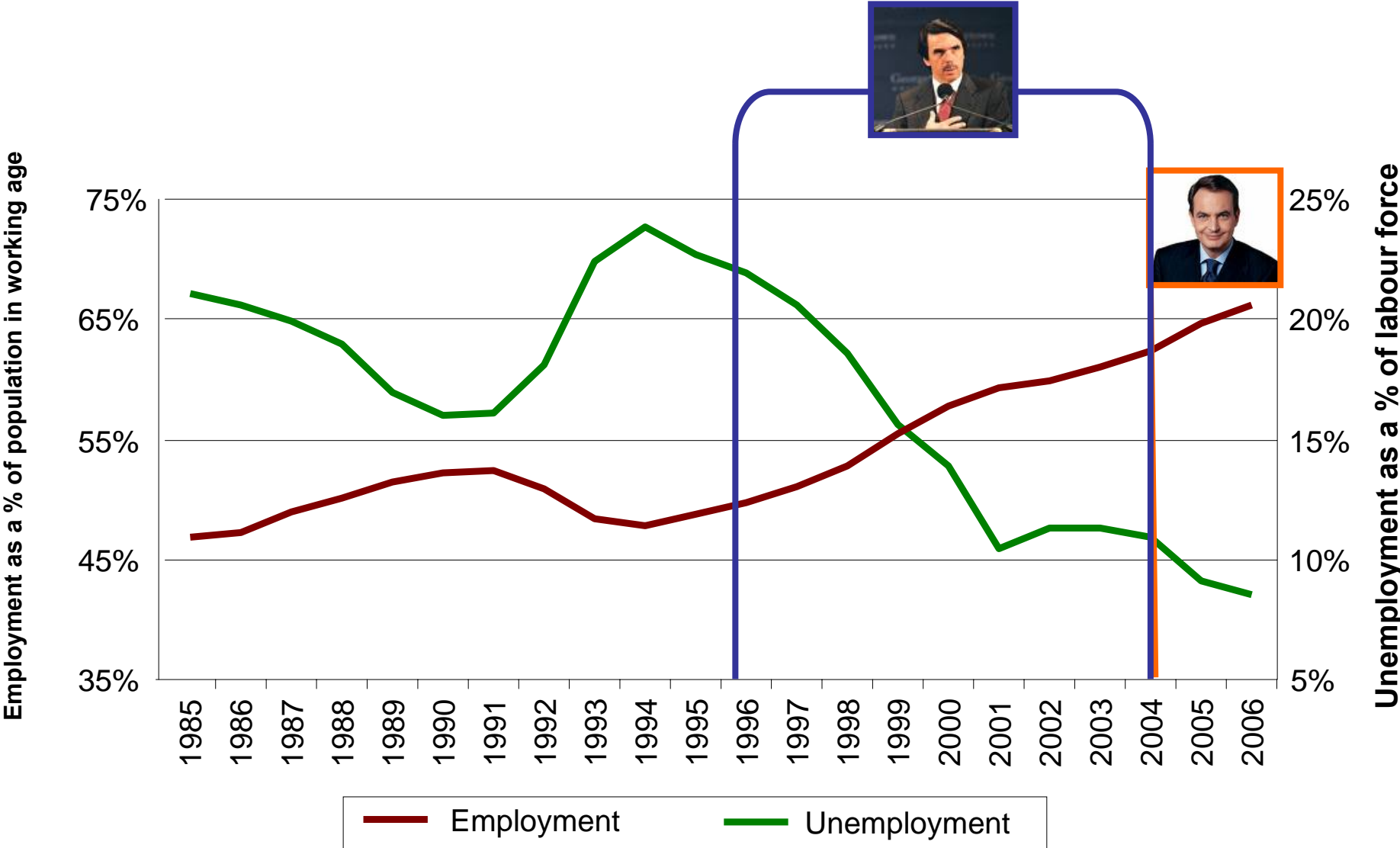
Reducing unemployment is not a popular business

- Under Berlusconi II (June 2001- May 2006) 1,354,320 jobs were created. Yet support for the Govt fell by 43%.
- Under Prodi II (May 2006 - December 2007) 432,512 jobs were created. Yet consensus fell by 51%.
- Aznar had to go in spite of 4,982,050 jobs created and halving the Spanish unemployment rate.

Italy



Spain



Outline

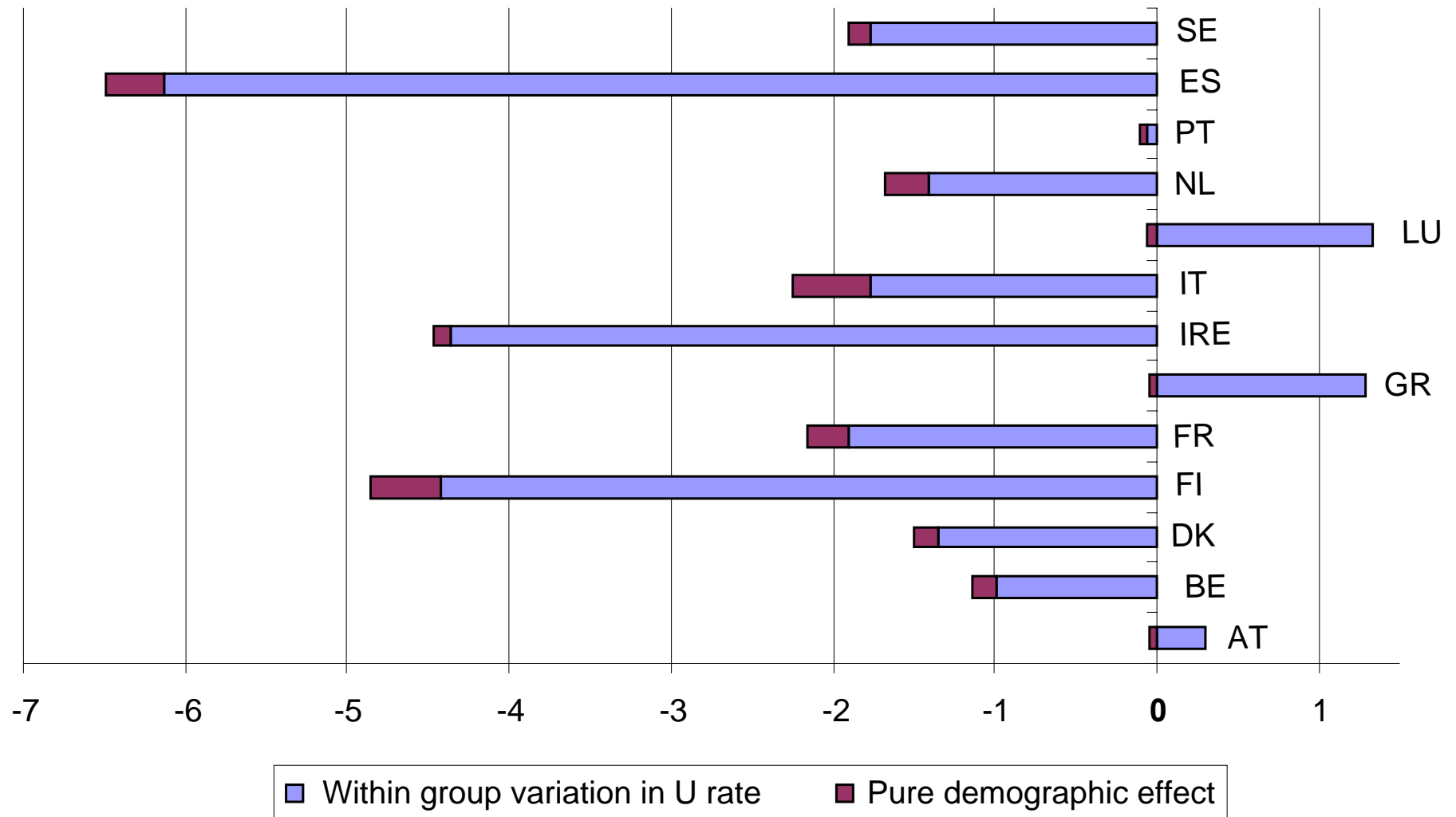
- A European dream..... turning into a European nightmare
- **Why?**
 - a simple explanation
 - looking at flows
- Can we cheat the employment labour productivity tradeoff?

The simple explanation

- Lower unemployment could simply be related to demographics.
- Insofar as unemployment rates are higher for the young people than for the other age groups, the ageing of Europeans may involve a reduction of unemployment.
- Is this the reason why we no longer see mass unemployment in Europe?

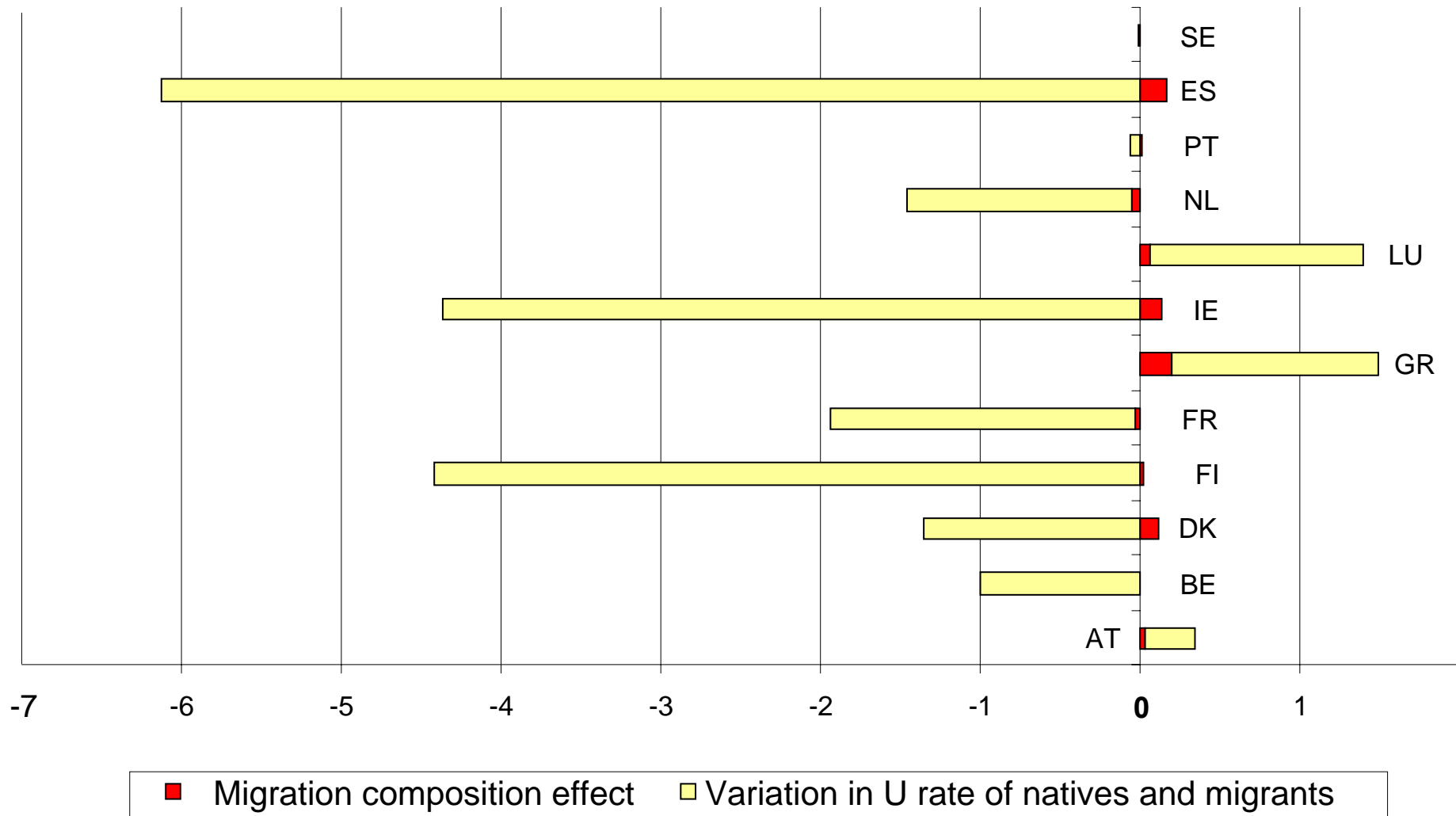
No. It isn't

1995-2004 Variation of Unemployment as a % of the Working Age Population

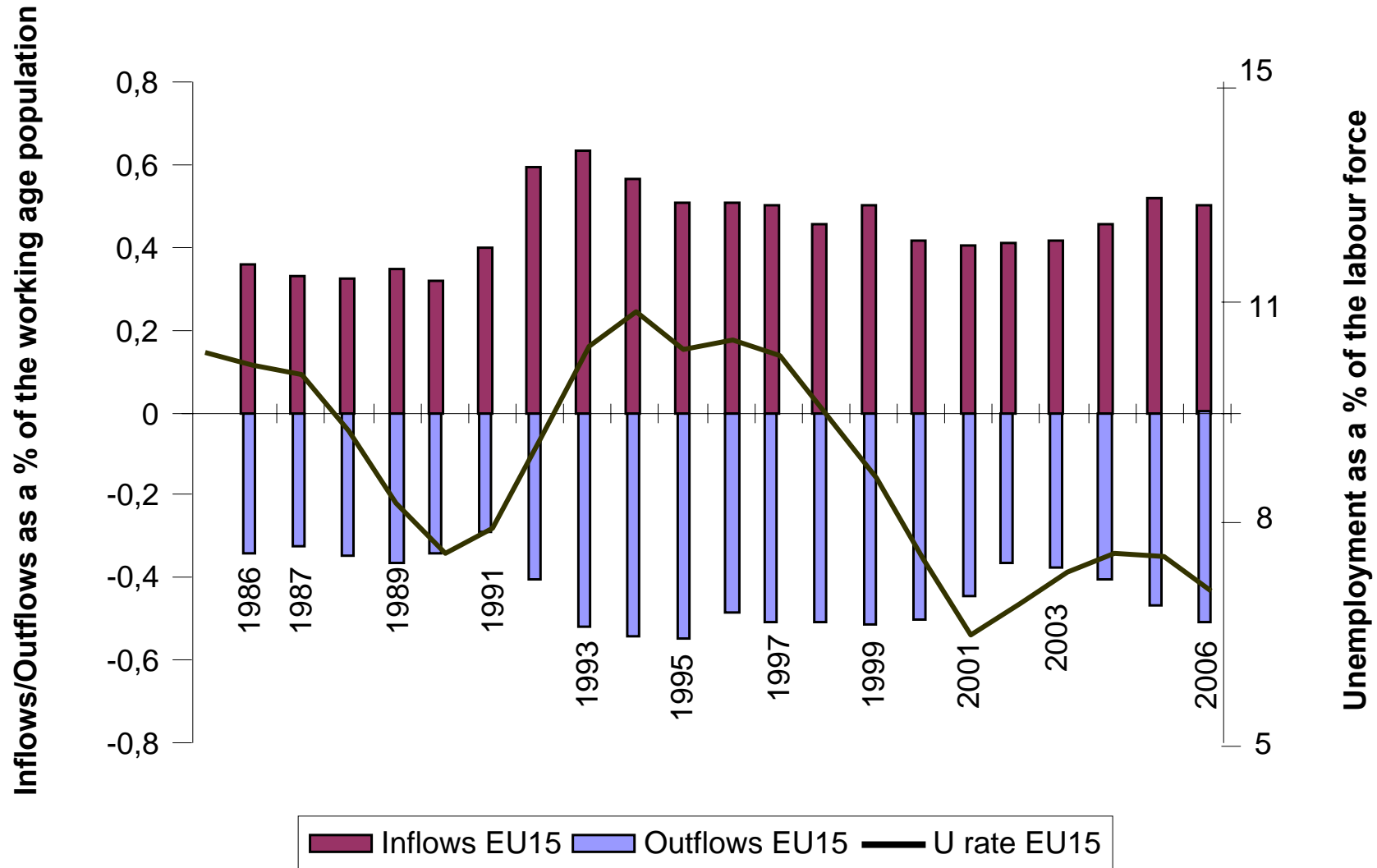


Also more migrants, but they have higher unemployment rates than natives

1995-2004 Variation of Unemployment as a % of the Working Age Population



Unemployment declined with *larger* unemployment inflows



Let us look at transition matrices

	Employment _t	Unemployment _t	Inactivity _t
Employment _{t-1}	93,5	3,0	3,5
Unemployment _{t-1}	30,0	47,3	22,6
Inactivity _{t-1}	3,7	1,8	94,6

Yearly Average
2001 – 2004

Out of 100 hundred unemployed, 30 find a job
...and 23 leave the labour market altogether
within a year
another 47 remain unemployed....

What do these transitions imply in terms of the long-run unemployment rate?



1985 – 1988

	Employment _t	Unemployment _t	Inactivity _t
Employment _{t-1}	93,1	3,2	3,7
Unemployment _{t-1}	29,0	56,5	14,1
Inactivity _{t-1}	2,8	1,7	95,5

$$\text{Mobility Index} = (S - \text{tr}(M)) / (S - 1)$$

where S denotes the number of labour market states and tr(M) the trace of the transition matrix

28%

In Europe more mobility across labour market states than 15-20 years ago

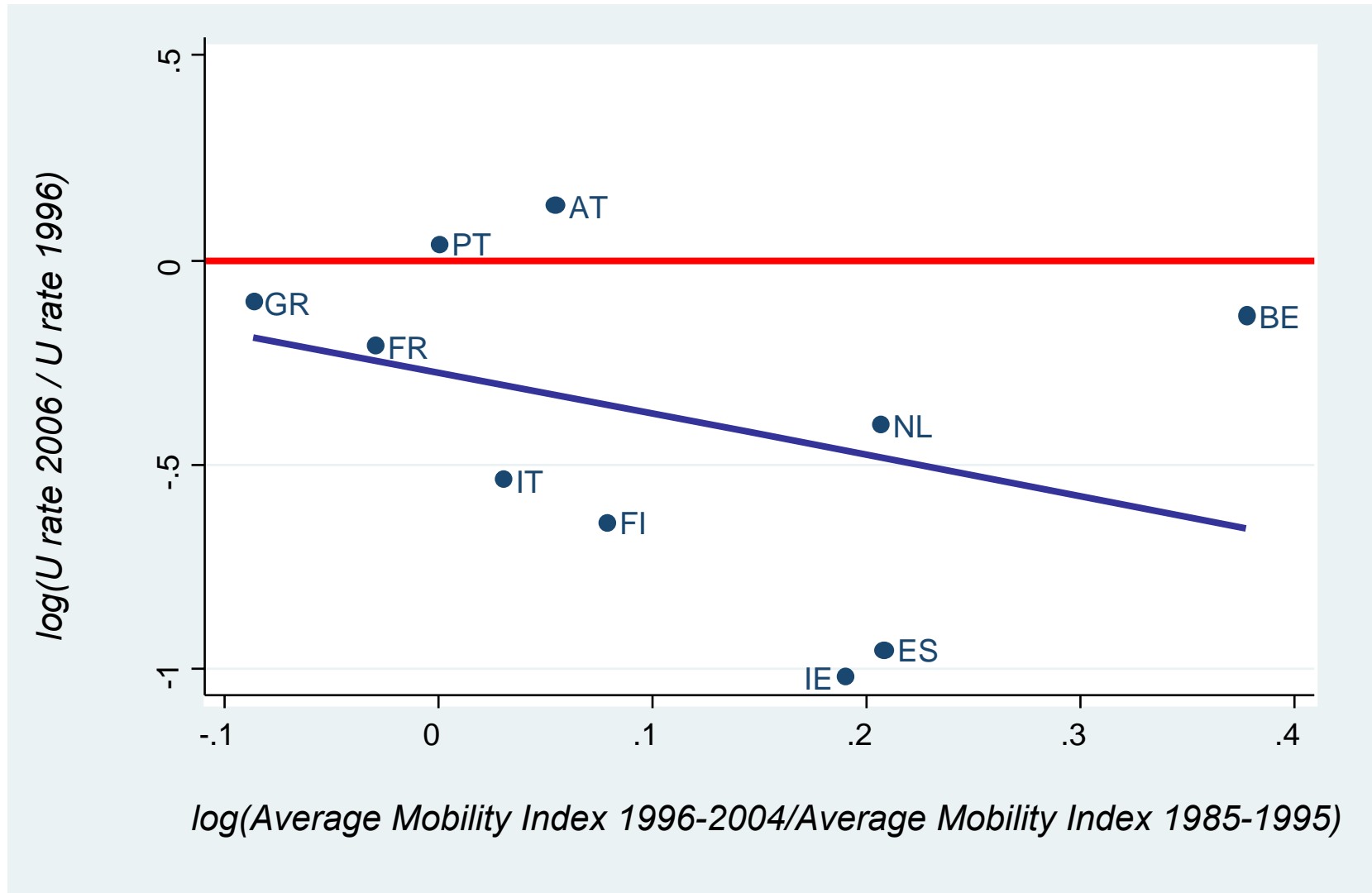
2001 – 2004

Mobility Index

32%

	Employment _t	Unemployment _t	Inactivity _t
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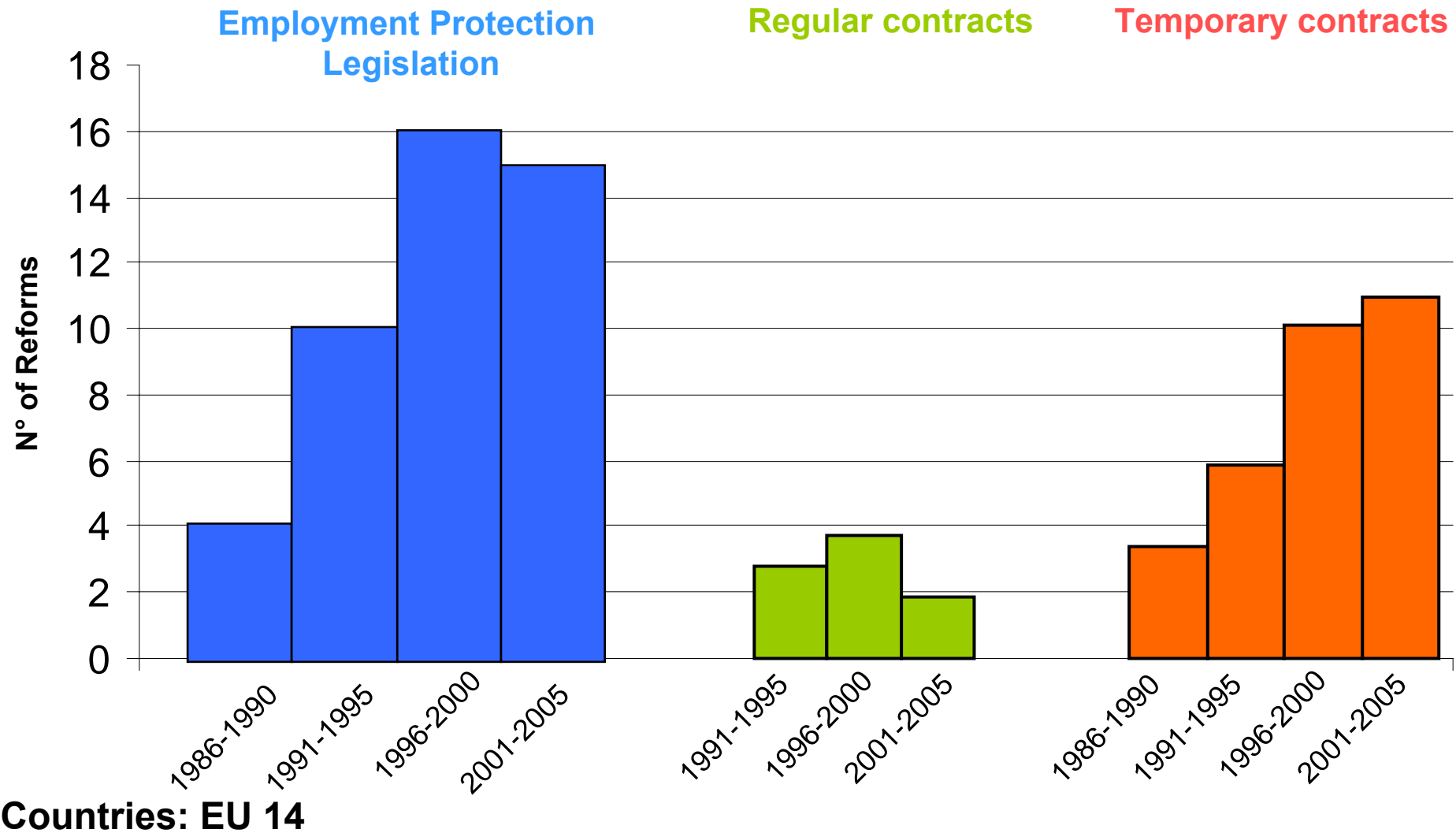
Increase in mobility in the countries with the strongest unemployment declines



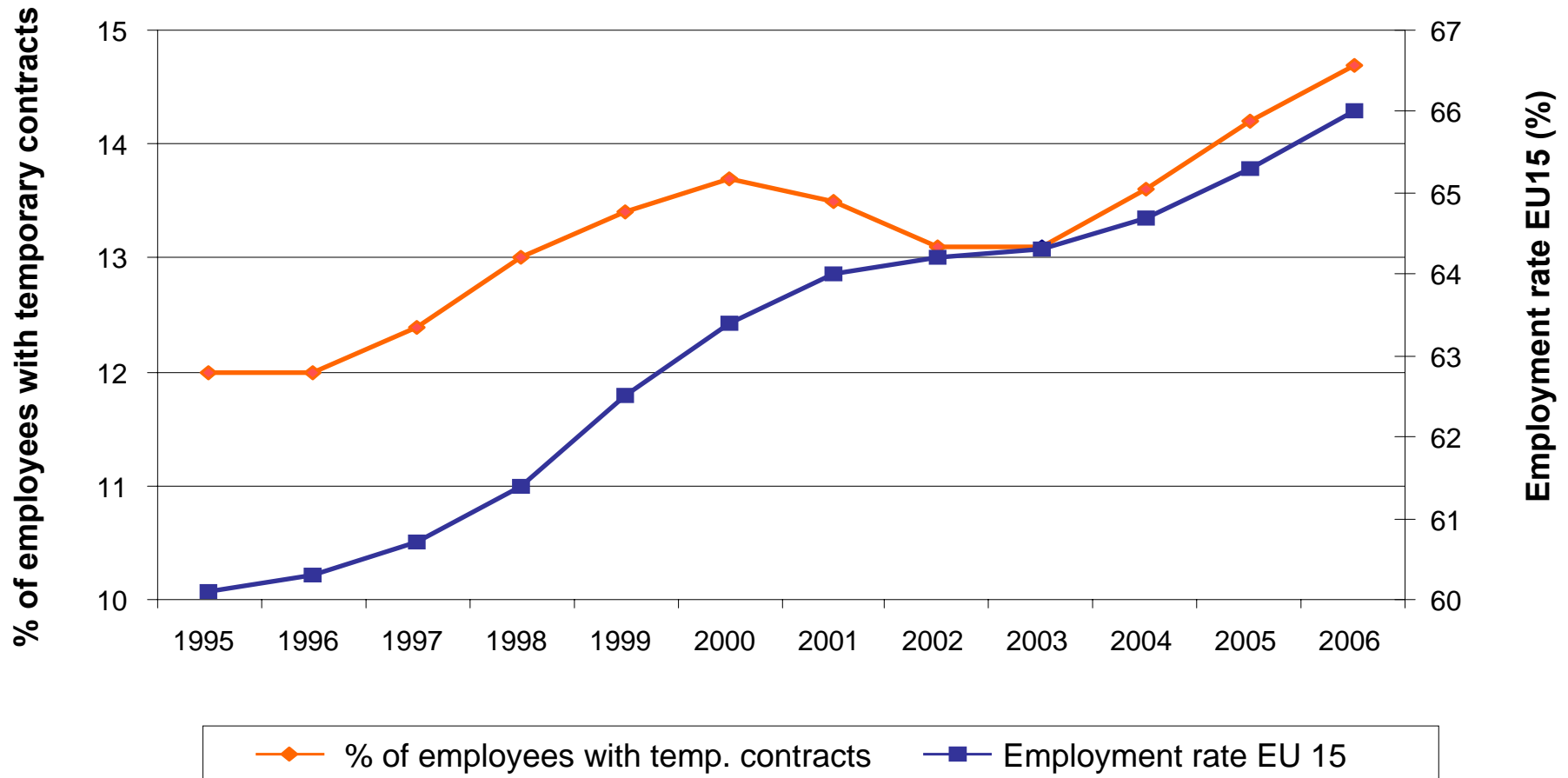
Why did mobility increase?

- Multivariate analysis (across countries and over time) of the determinants of mobility indexes.
- Reduction in the strictness of Employment Protection Legislation (EPL) for *temporary contracts* increases mobility by 5%.
- Reduction of EPL strictness for *regular contracts* increases mobility by 2%.
- Controlling for GDP growth and the share of immigrants in the population.

Acceleration of reforms of EPL

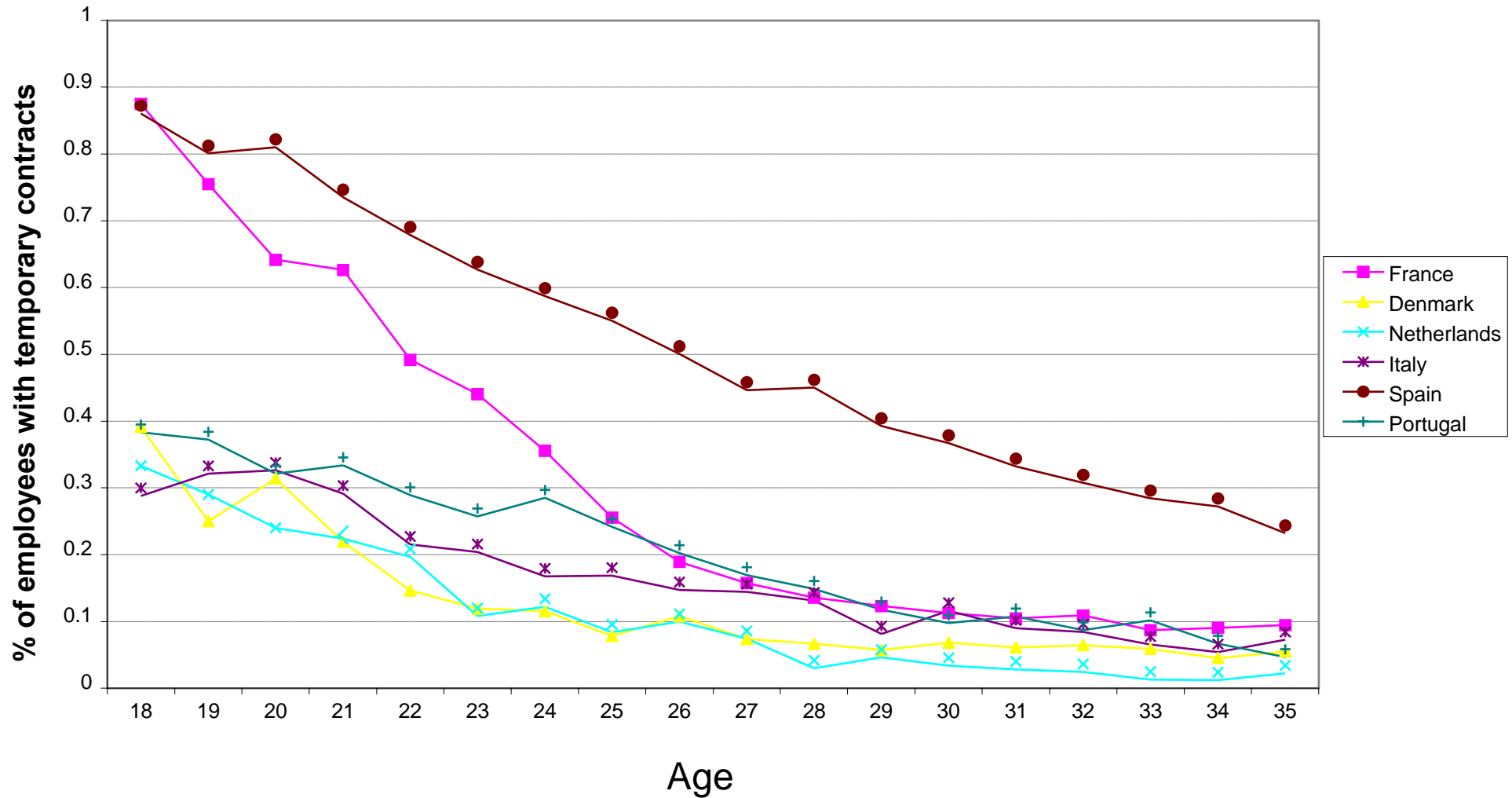


The growth of temporary employment in Europe





A port of entry?...

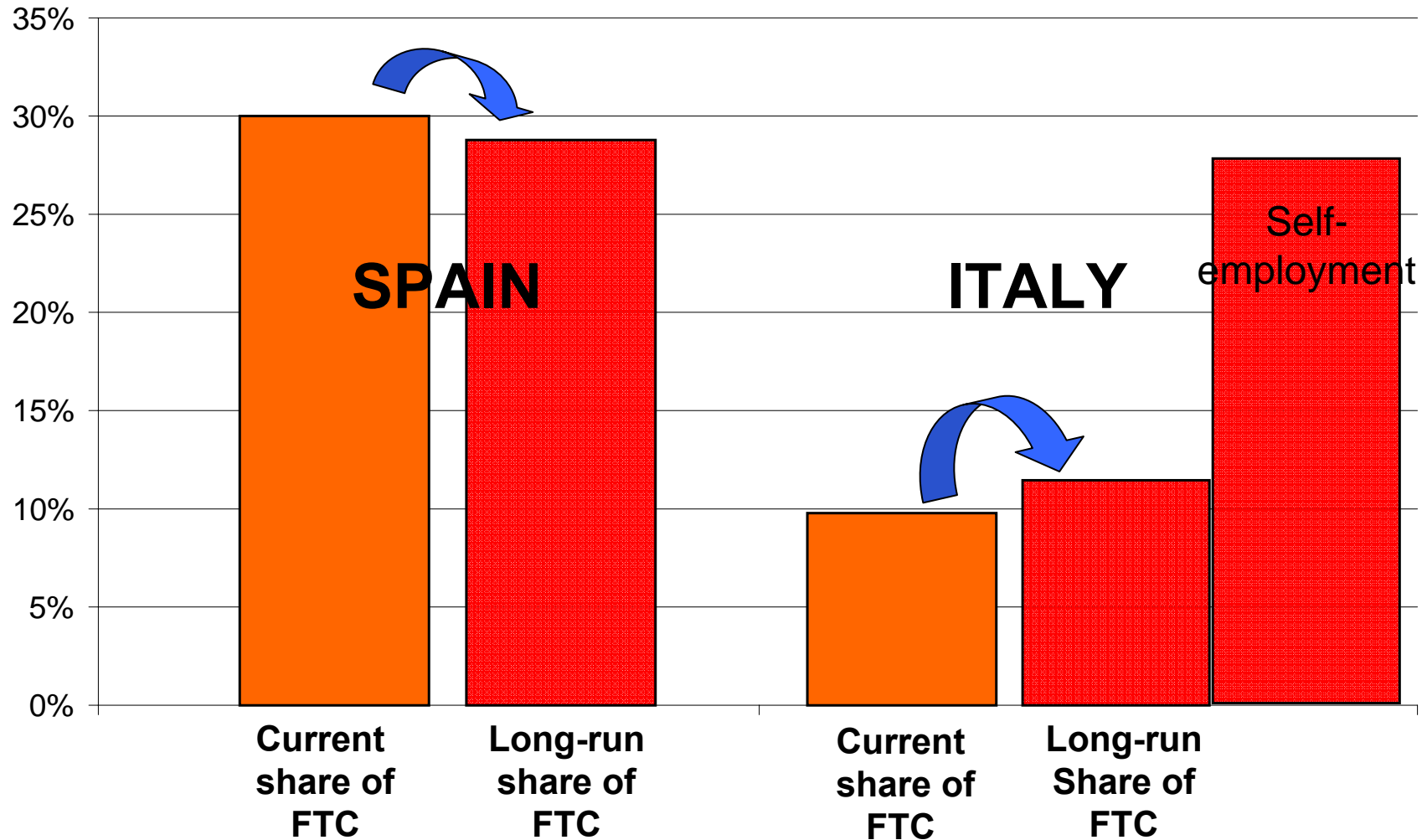


... or a dead end?

Spain

	2004	Permanent Contracts	Fixed Term Contracts	Unemployment	Inactivity
2003					
Permanent Contracts		97.2	1.1	1.0	0.7
Fixed Term Contracts		4.8	82.6	9.0	3.5
Unemployment		2.5	20.1	67.0	10.4
Inactivity		0.4	2.4	3.9	93.3

Temporary contracts: a longlasting phenomenon



Social cohesion?

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Moreover

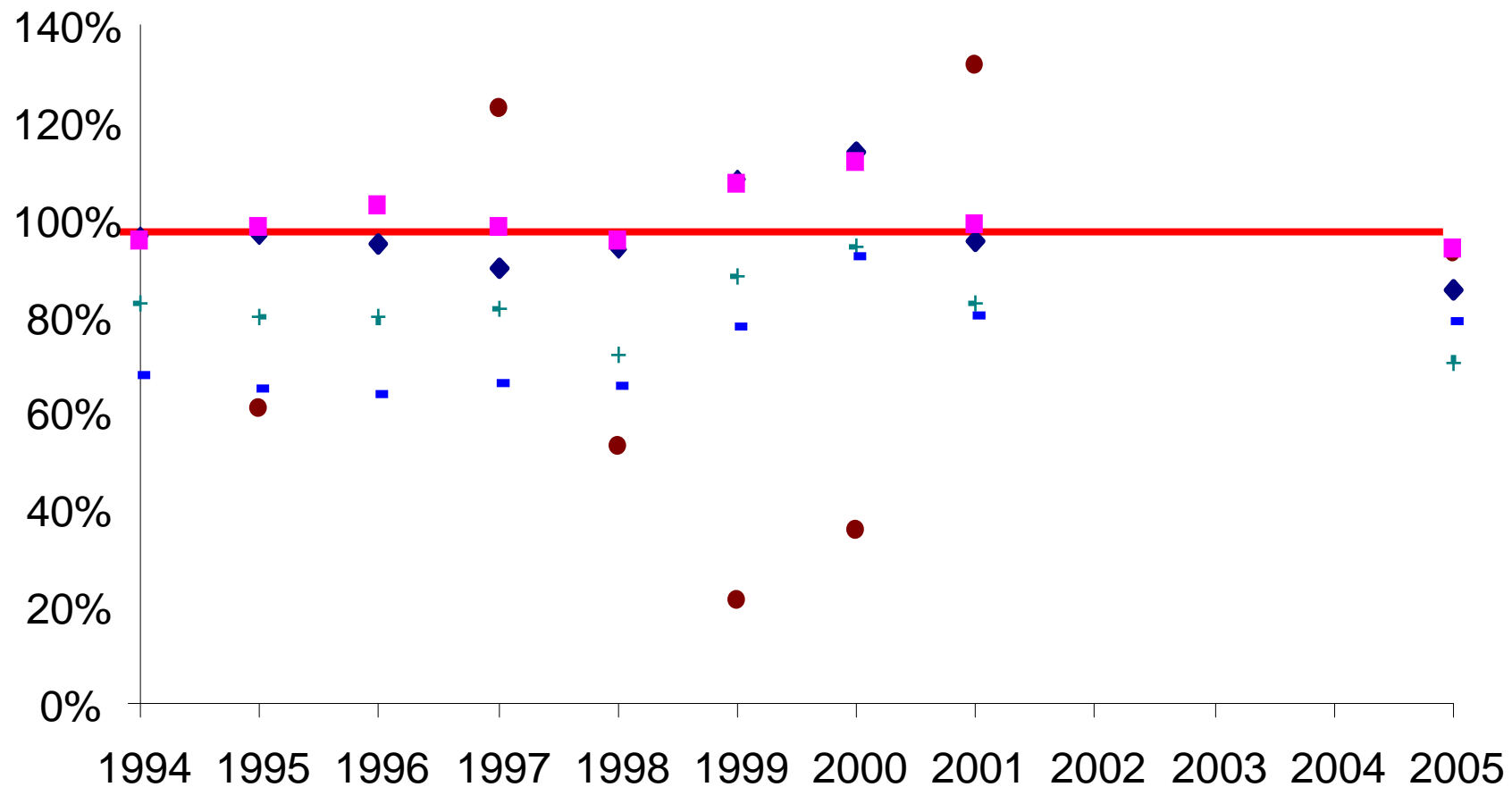
- Also workers with permanent contracts may suffer a capital loss with EPL reforms as their welfare includes expectations of future job losses. “Insiders” cannot be fully insulated from reforms!
- Decline in their welfare associated with an increase in the probability of job loss (λ) is

$$-(w-w^r)/(r+\lambda)$$

where w is the market wage, w^r is the reservation wage and r is the interest rate

Easier to (re)enter the labour market but often at lower wages

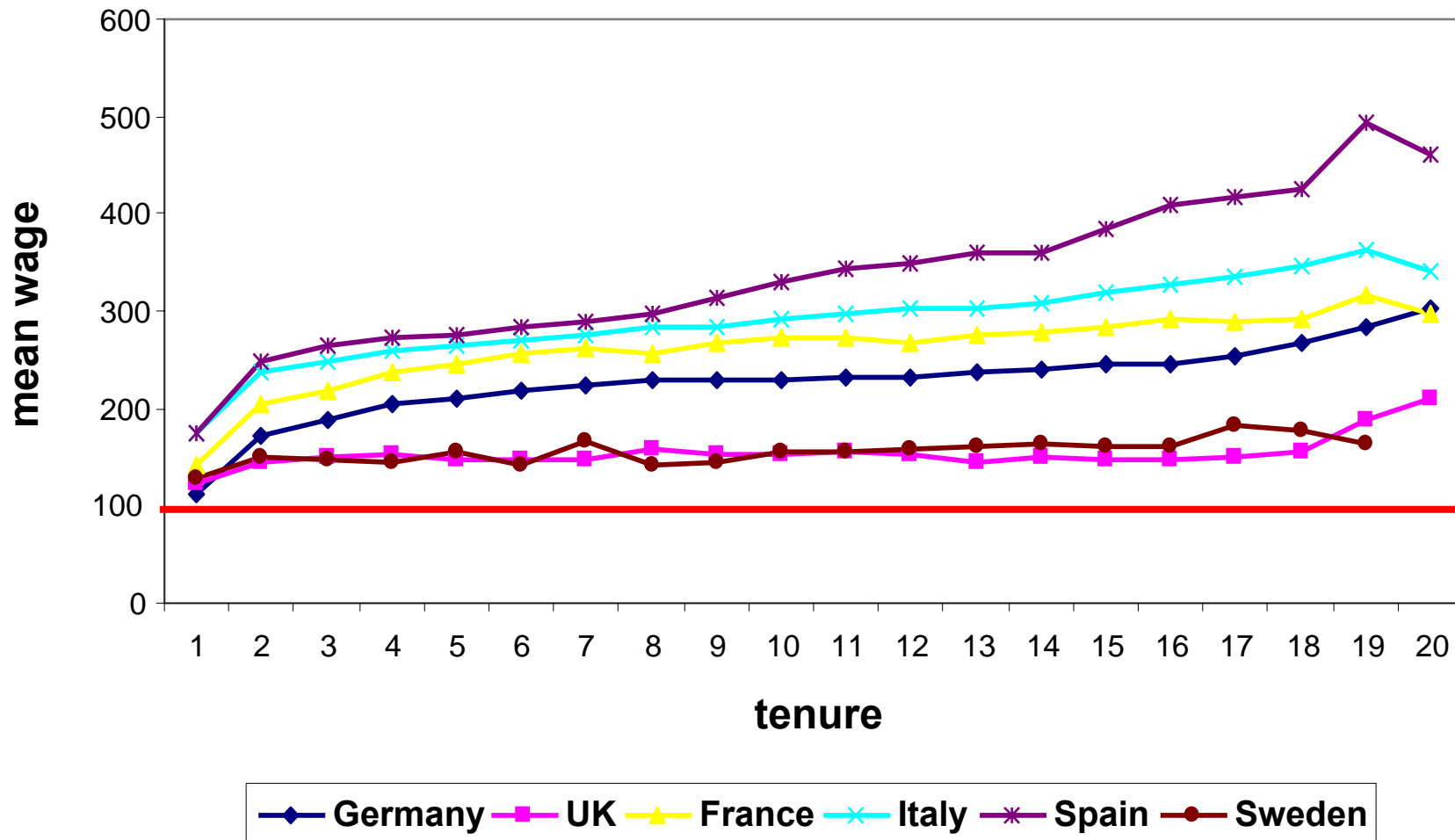
Entry wage in a new job as a % of the average wage for different groups



Source: ECHP (BE, DE, DK, ES, FR, GR, IE, IT, LU, NL, PT, UK), EUSILC (AUT, BE, ES, GR, IE, IT, PT, UK).

As wage increases are mostly related to tenure

(unconditional wage-tenure profiles, source ECHP)



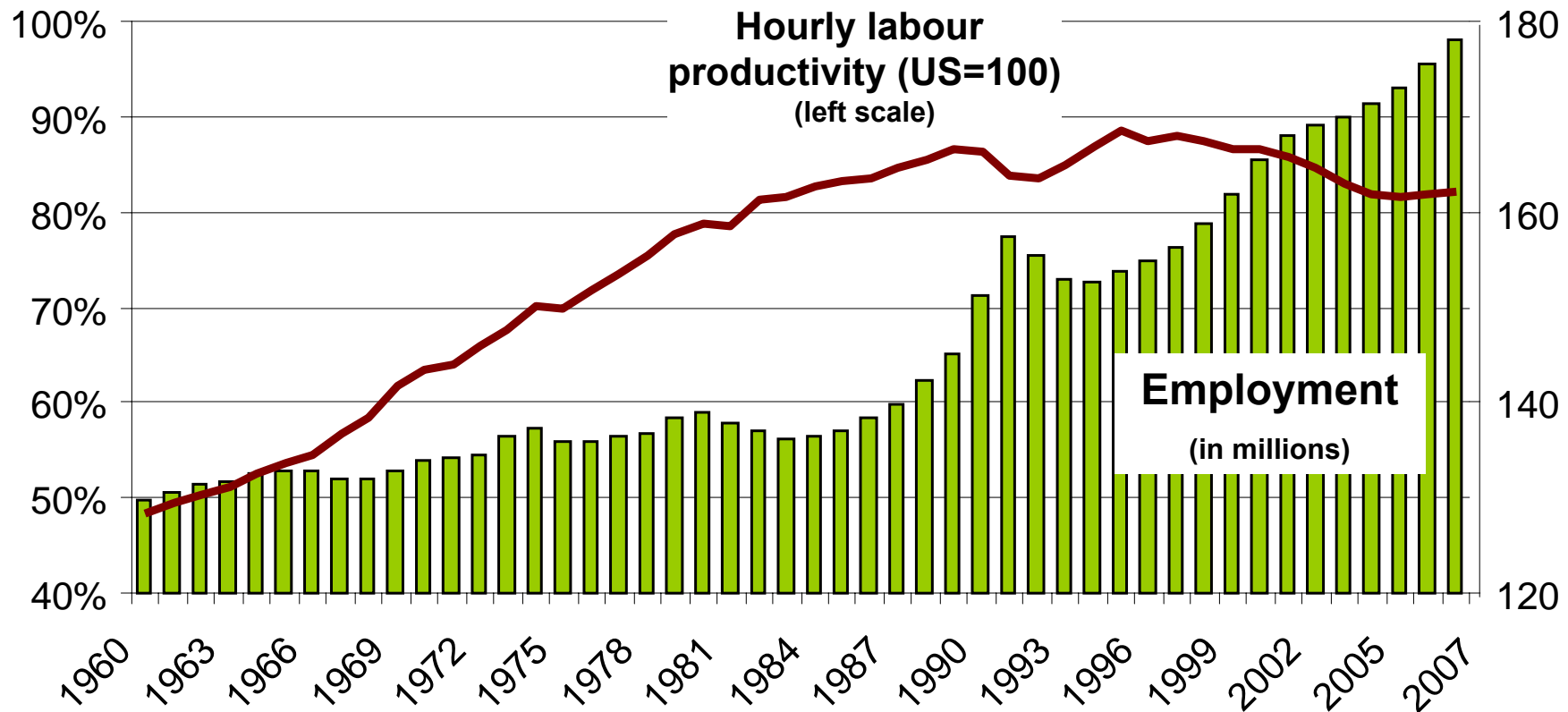
Outline

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How to make Europeans happier about lower unemployment?

- Providing more employment security is not an option.
- More labour market risk makes risk-averse individuals unhappy unless it is accompanied by higher wages.
- We need higher wages to provide popular support to reforms in Europe.
- But higher wages require higher labour productivity.

Can Europe increase both employment *and* productivity?



Source: Groningen Growth & Development Centre, Total Economy Database

What do employment protection reforms do to labour productivity?

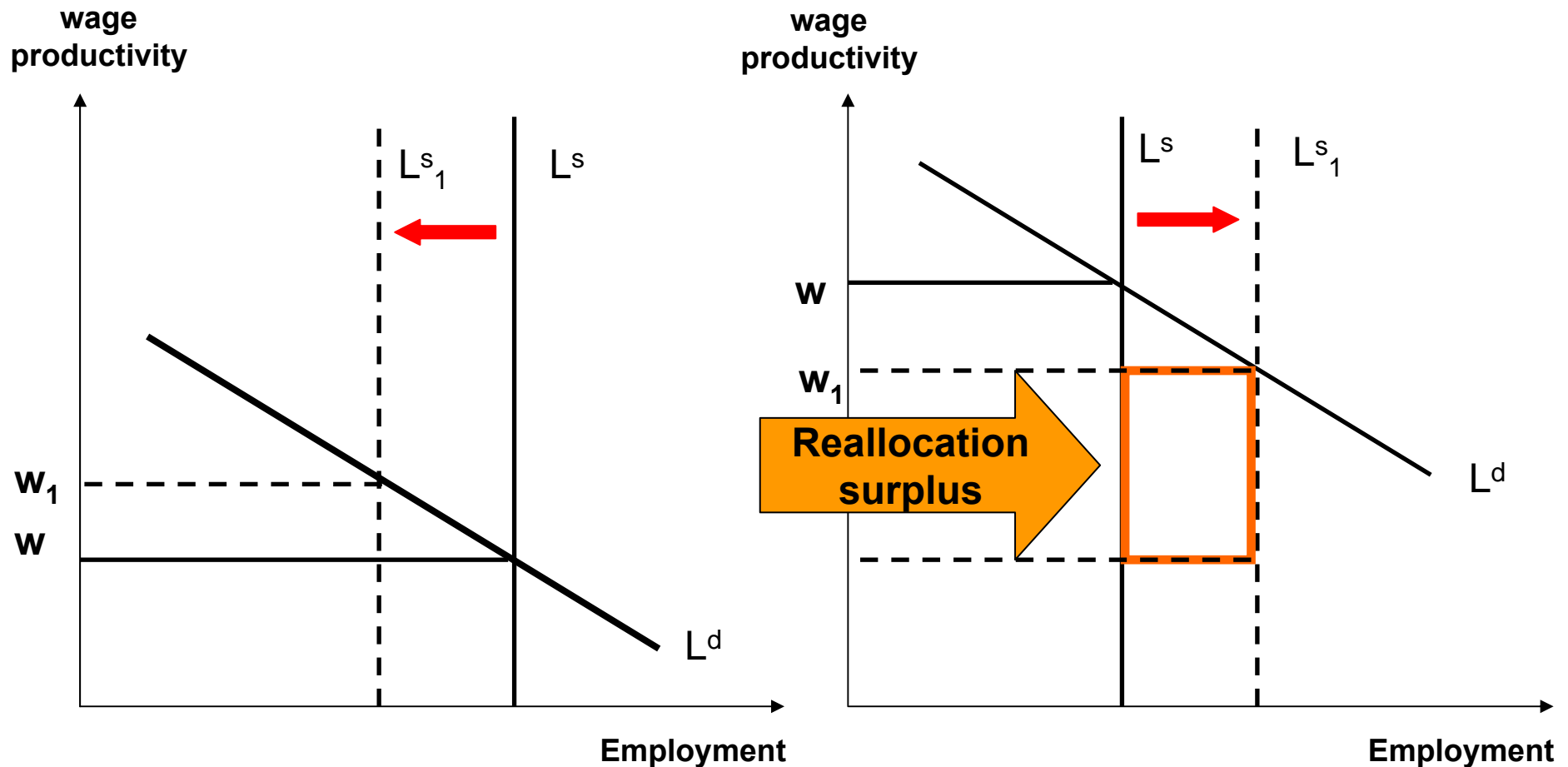
- On the *job destruction* margin: they reduce the number of low productivity jobs. This *increases* productivity.
- On the *job creation* margin: they may discourage investment in human capital as shorter tenures reduce incentives to training on-the-job. This *reduces* productivity.

How to “cheat” the tradeoff then?

Increase wages-productivity at entry. More investment in human capital.

- *Before the job*: better education systems via compulsory evaluation of *all* schools
- *On the job*:
 - **tenure track** to permanent contracts (no segregation into temporary contracts)
 - **decentralised wage bargaining** that rewards productivity rather than simply tenure

Reallocation increases average productivity and wages



In Duisenberg's words

- “The euro is not and cannot be a cure for all European problems. The introduction of the euro will not in itself solve the unemployment problem. Monetary policy is neither the cause nor the solution of the unemployment problem.
- Structural reforms are needed to attack it. Fortunately, this insight is gaining broader support. The challenge now is to translate it into sustained action. Carrying out structural reforms is politically difficult, since *they may be painful in the short term and only bear fruit over a longer time scale*. However, it is encouraging to note that those countries which have implemented structural reforms have indeed been more effective in coping with the unemployment problem”.

Lecture at the Per Jacobsson Foundation in Washington, 26/9/99