Box 6

A COMPARISON OF EMPLOYMENT DEVELOPMENTS IN THE EURO AREA AND THE UNITED STATES SINCE 1995

Although the euro area's performance in terms of economic activity has been weaker than that of the United States over the past decade, employment developments in the two economies have on average been similar. This may be seen as an indication that employment growth in the euro area reflects not only cyclical developments, but also some structural improvements in the labour market. Indeed, many estimates suggest that the structural rate of unemployment has fallen in the euro area since 1995, albeit remaining at a high level.[1] This box compares employment developments in the euro area and the United States since 1995.

1 See Box 6 entitled "A longer-term perspective on structural unemployment in the euro area" in the August 2005 issue of the ECB Monthly Bulletin.

Between 1995 and 2005, the average quarter-on-quarter growth rate of real GDP was 0.8% in the United States as opposed to 0.5% in the euro area (see Chart A). Nevertheless, employment growth in the same period was similar in the two economies (0.3% quarter on quarter on average), with the euro area and the United States increasing employment by around 16 and 17 million jobs respectively.

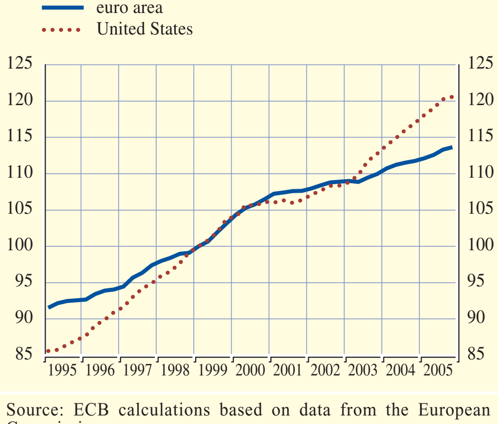
This overall similarity of employment performance notwithstanding, employment developments in the two economies differed at times during the period (see Chart B). In line with the relative performance in activity, employment growth in the United States outpaced that in the euro area until 1998. Then, over the next two years, employment grew at about the same rate in both economies. However, during the period 2000-2003, employment increased on average at a quarterly rate of 0.25% (and cumulatively by around 3.5%) in the euro area, while quarterly employment growth in the United States was on average close to zero (and fell by a cumulative 0.7%). Since 2004 employment growth has picked up considerably in the United States (reaching a quarterly rate of 0.4% on average in the last two years), but has slowed slightly in the euro area (to an average rate of 0.2% quarter on quarter).[2]

In the latter part of the decade, employment developments thus differed markedly from the pattern of general economic performance in the United States, unlike in the euro area. This was reflected in labour productivity developments. Labour productivity growth[3] was on average significantly higher in the United States than in the euro area during the period 2000-2005 (see Chart C).

It is difficult to ascertain whether the observed differences in labour productivity performance were the cause or the consequence of the differences in employment developments. However, in the United States, the increase in trend labour productivity underpinned by a more efficient

Chart A Real GDP developments in the euro area and the United States

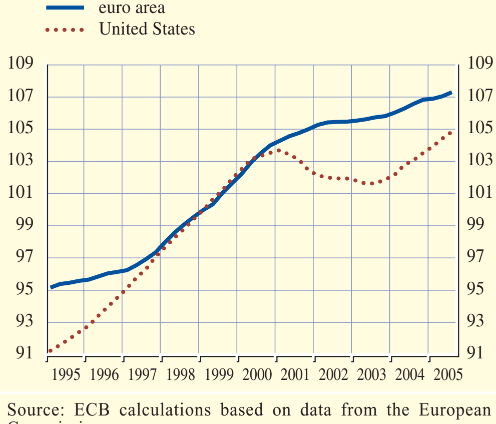
(index: Q1 1999 = 100)



Source: ECB calculations based on data from the European Commission.

Chart B Employment developments in the euro area and the United States

(index: Q1 1999 = 100)



Source: ECB calculations based on data from the European Commission.

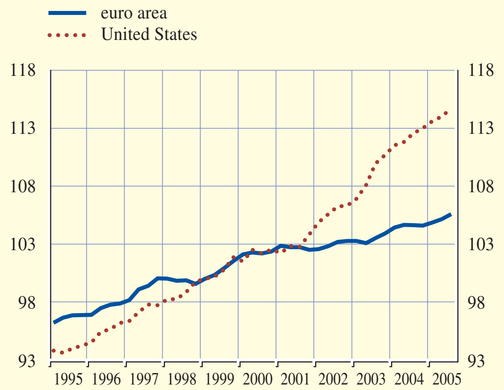
2 Analysing employment in terms of total hours worked gives a very similar picture, although the difference between the euro area and the United States after 2000 is less pronounced.
3 Labour productivity is calculated here as real GDP divided by the number of people employed.

use of IT capital accumulated during the 1990s seems to have played a significant role in bringing about the differences in employment growth.

In the euro area, employment has increased continuously over the last few years. This may be related to sustained real wage moderation, but may also reflect the progress in labour market reforms achieved in some euro area countries. Some of these reforms were specifically aimed at increasing labour market participation.[4] However, the very same measures which raised labour market participation may have temporarily led to lower productivity growth. In recent years, active labour market policies have been aimed more at disadvantaged groups, resulting in an increase in the employment of low-skilled workers (with lower potential productivity). Lower productivity in the euro area, however, also reflects other factors, such as the relatively low use of new productivity-enhancing technologies.[5]

Chart C Labour productivity developments in the euro area and the United States

(index: Q1 1999 = 100)



Source: ECB calculations based on data from the European Commission.

Looking ahead, a challenge for the euro area is to raise both labour utilisation and labour productivity growth. A good combination of both can pave the way for higher potential growth in the longer run. In this respect, reforms which enhance productivity (e.g. policies aimed at open and competitive product markets, increasing educational attainment, stimulating innovation and promoting the use of productivity-enhancing technologies) in the euro area are necessary to prepare the ground for future solid growth in economic activity.

4 Labour market reforms introduced in Germany and France, for example, are discussed in detail in Box 5 entitled "Some country-specific factors behind recent euro area employment developments", in the January 2006 issue of the Monthly Bulletin. See also S. Nickell (2003): "Labour Market Institutions and Unemployment in OECD Countries", *CESifo DICE Report* 1, No 2, pp. 13-26 for more evidence.

5 See also Box 9 entitled "Developments in euro area labour productivity" in the March 2005 issue of the Monthly Bulletin.