

Box 6

LABOUR SUPPLY AND EMPLOYMENT IN THE EURO AREA: DEVELOPMENTS AND CHALLENGES

On 25 June the ECB published its 2008 Structural Issues Report entitled “Labour supply and employment in the euro area countries: developments and challenges”. This report describes and analyses the main developments in labour supply and its determinants in the euro area since the early 1980s.¹ Furthermore, it reviews the links between labour supply and labour market institutions in order to assess how well labour supply reflects the demand for labour in the euro area and to identify future challenges for policy-makers.

This box briefly reviews the main developments in labour supply for the period 1996-2007, which were generally favourable:²

(i) Euro area employment growth accelerated significantly, with the equivalent of 21.6 million more people entering employment. This contributed to a substantial 3.9 percentage point reduction in the unemployment rate, which stood at 7.5% in 2007 (see the table). Since 1996, the total labour market participation rate³ has risen by 5.6 percentage points to 70.8% in 2007 and the employment rate rose by 7.7 percentage points to 65.5%.

1 The cut-off date for euro area data included in the report was 14 December 2007. The euro area aggregate therefore refers to the 13 countries that formed the euro area in 2007.

2 These developments are based on annual data from the spring surveys of Eurostat’s Labour Force Survey (EU-LFS) up to 2007. More recent data suggest some further improvement.

3 The participation rate refers to the number of people employed plus the number unemployed divided by the total working age population.

(ii) The composition of labour supply changed over the period under review, with growing numbers of women and immigrants entering the labour market and older workers remaining in the labour market for longer. The participation rates of these groups increased by 9.0 percentage points, 7.4 percentage points and 10.5 percentage points respectively from 1996 to 2007. Over time, changes in educational levels, preferences and social norms have played a role in boosting female labour market participation.

(iii) Experiences with immigration vary considerably from country to country, but on the whole, non-EU15 immigrants⁴ contributed positively to labour supply and employment during the period under review, enhancing competition in labour markets and helping to fill skills shortages. Alongside the increase in immigration to the euro area, cross-border commuting within the euro area rose threefold.

(iv) The share of the working age population with a higher level of education, in particular tertiary education, increased by 6 percentage points to 20.7% in 2007. This implies that the number of people with tertiary level qualifications rose by 16.7 million. The proportion of low-skilled workers in the euro area decreased by 9 percentage points to 37.7% over the period under review.

(v) While the number of workers increased, the average number of hours worked per week declined by a total of 1.2 hours in the euro area. The ratio of part-time employment to total employment rose by around 5 percentage points.

These encouraging developments result in part from the implementation of product and labour market reforms and wage moderation. However, there is no room for complacency. Unemployment rates are still unacceptably high and much higher than in other developed

4 Immigrants from the new EU Member States and non-EU countries.

Euro area participation, employment and unemployment rates

(percentage points; percentages)

	Total change over the period 1996 to 2007			Level in 2007		
	Participation	Employment	Unemployment	Participation	Employment	Unemployment
Total	5.6	7.7	-3.9	70.8	65.5	7.5
According to gender						
Males	2.1	4.1	-2.9	78.4	73.2	6.6
Females	9.0	11.2	-5.5	63.2	57.8	8.6
According to age						
15-24 years old	0.3	3.7	-7.8	44.0	37.3	14.8
25-54 years old	4.8	7.0	-3.2	84.6	79.1	6.6
55-64 years old	10.5	10.5	-1.9	46.4	43.4	6.5
According to level of education						
Low	5.2	6.9	-3.9	63.5	57.6	9.3
Medium	2.9	4.4	-2.4	80.4	75.3	6.4
High	0.6	2.8	-2.5	88.3	84.7	4.1
According to nationality						
Nationals	3.7	6.4	-4.5	70.9	65.9	7.0
Other EU15 citizens	2.5	3.9	-2.2	73.7	67.6	8.2
Non-EU15 citizens	7.4	9.5	-5.2	69.6	59.3	14.7

Sources: EU-LFS (spring data), ECB and Nationale Bank van België/Banque Nationale de Belgique calculations.
Note: EU15 refers to those countries that formed the EU prior to 2004.

economies such as the United States or Japan. In addition, unemployment rates are particularly high for some groups of workers (see the table). For example, in 2007 the unemployment rate was 14.8% for young people (up to 33% for 15-19 year olds in some countries), 9.3% for low-skilled workers (up to 17% in some countries) and 14.7% for non-EU15 immigrants (up to 28% in some countries). Moreover, demographic projections show that, unless participation rates increase even further, the increase in the number of people entering the labour market will soon no longer be sufficient to compensate for the reduction in size of the working-age population. Finally, progress in terms of structural reform has varied considerably across countries.

Looking ahead, it is important that countries learn from each other, as well as from best practices, in order to develop new and improved labour market institutions and structural policies. The report identifies the following policy measures as particularly important.

First, there is a need to further optimise structural policies in the euro area and to increase labour market participation and employment among all groups of society. Lower marginal tax rates, stricter work availability requirements and reduced incentives to retire early would contribute to stimulating labour supply. Fewer restrictions on working time and labour contracts alongside well-designed “work/family reconciliation” policies (such as the provision of affordable childcare, parental leave and part-time work opportunities) would promote labour market participation.

Second, labour market institutions need to be more flexible in order to better match those seeking a job with the characteristics of firms’ labour demand (by skill, sector and region). Wage developments should reflect local labour market conditions (such as regional and skill-specific unemployment rates, regional and sectoral productivity growth and workers’ skills), and institutional arrangements that hinder the employment of low-skilled workers (such as excessive minimum wages) should be avoided.

Third, there is a need to improve skills and knowledge levels, as well as to increase the transferability of skills. Over time, bringing unemployed or inactive people into jobs will enhance individuals’ labour productivity and thus real wages. Good-quality education is of the utmost importance. The efficiency and service orientation of educational establishments should be improved and the labour market should play a greater role in signalling to education systems and workers which skills are in short supply.

Finally, the euro area should make better use of skills from outside the euro area. Its immigration policy should take into account the skills needed by the labour market, facilitate labour mobility and ensure the successful integration of immigrants into the active workforce and society as a whole. Selective migration policies that limit labour mobility within the EU should be avoided and replaced by measures that support labour market mobility, such as the increased portability of pension rights. In order to fully reap the benefits of the euro and to allow adjustment mechanisms to operate efficiently within the enlarged currency area, it is important that all remaining barriers to labour mobility within the euro area are removed.

These policy measures also have implications for monetary policy. The implementation of structural policy measures which enhance labour supply and employment growth speeds up the pace at which an economy can grow without higher inflation. Increasing the number of people in

employment and the level of skills among the workforce will also help to support the euro area's potential output and per capita income, as well as to finance pension and health care systems. Well-designed and flexible labour and product market institutions are essential for this process. Greater flexibility in euro area labour markets and wages would reduce adjustment costs and inflation pressures in the event of adverse supply shocks and would augment the economy's resilience, thus facilitating the conduct of the stability-oriented monetary policy of the ECB. In addition, there is a need for greater flexibility in terms of wages and labour mobility in order to limit employment losses in the event of adverse country-specific shocks and thereby facilitate the functioning of EMU.