

### Box 3

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

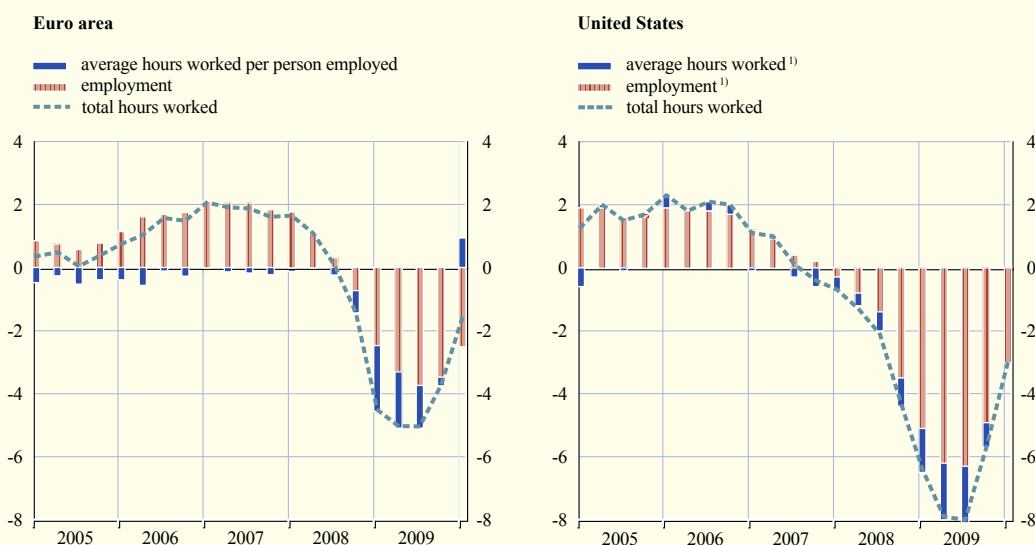
The recent economic and financial turmoil has had a heavy impact on labour markets on both sides of the Atlantic, resulting in sharp contractions in employment and notable increases in unemployment. This box compares the recent experiences of the two economies and examines the policy implications of recent labour market adjustments.

It is well known that labour market developments tend to lag economic activity. Moreover, direct comparisons between the euro area and the United States are further complicated by the fact that the effects of the financial turmoil and the ensuing downturn were felt in the United States somewhat earlier than in the euro area, with US quarterly GDP growth slowing sharply from the third quarter of 2007, while output growth in the euro area remained resilient until the first quarter of 2008. Overall, however, it seems that the contraction in economic activity was rather larger in the euro area than in the United States, with a peak-to-trough decline in real GDP of the order of 5.3% in the euro area, compared with 3.7% in the United States.<sup>1</sup> In the United States, the sharp contraction in output appears to have triggered a very rapid adjustment in employment, with few signs of stabilisation until late 2009 (see Chart A). In the euro area, by contrast, employment appears to have been rather slower to react and has not adjusted to the same extent, despite the relatively larger contraction in economic activity.

<sup>1</sup> The US recession began officially in the final quarter of 2007, according to the US National Bureau of Economic Research (NBER) – a half year ahead of the recession in the euro area. However, US GDP growth turned negative only in the first quarter of 2008 and indeed GDP grew again in the second quarter of 2008 when the level of GDP actually peaked, as output was strongly boosted by a range of fiscal stimuli. In the peak-to-trough computation mentioned in the text, the peak refers to the fourth quarter of 2007.

Chart A Evolution of total hours worked in the business sector and contributions

(annual percentage changes; percentage point contributions)



Sources: Eurostat, the US Bureau of Labor Statistics and ECB calculations.

Note: The business sector excludes non-market services (including the public sector).

1) US employment data refer to the total number of jobs held (and thus may include a small proportion of people with more than one job).

### Developments in employment, hours worked and unemployment

Overall, since the onset of the recession in the United States more than 8 million jobs have been lost (i.e. around 6.0% of the total prior to the recession). By contrast, in the euro area employment has fallen by around 3.9 million (i.e. 2.6%) since the start of the recession.<sup>2</sup> Both economies have experienced a sharp reduction in total hours worked, although the overall decline has clearly been much larger in the United States.<sup>3</sup> Moreover, there has been a significant difference in the relative contributions from employment losses and working hour adjustments across the two economies. In both economies, firms have responded to the recession by reducing the average working hours of employees. But in the United States this effect has been dwarfed by the much greater contribution of job shedding to the reduction in total hours worked, while in the euro area (particularly in the industrial sector) proportionally more of the reduction in total hours worked has been achieved through reductions in the average weekly hours of employees.

In addition to these labour demand dynamics, both economies have seen significant adverse labour supply effects following the recent economic downturn. In the euro area, the stagnation in labour force growth since the third quarter of 2008 can be almost equally attributed to both slower population and participation growth.<sup>4</sup> By contrast, in the United States the contraction in the labour force (-0.2% since the third quarter of 2008) can be exclusively attributed to a very

2 For important methodological differences in the compilation of employment data in the euro area and the United States, see the article entitled "Comparability of statistics for the euro area, the United States and Japan" in the April 2005 issue of the Monthly Bulletin.

3 For details on the new euro area national accounts-based hours series, see the box entitled "New statistical series of hours worked, productivity and labour costs for the euro area" and the article entitled "Labour market adjustments to the recession in the euro area" in this issue of the Monthly Bulletin.

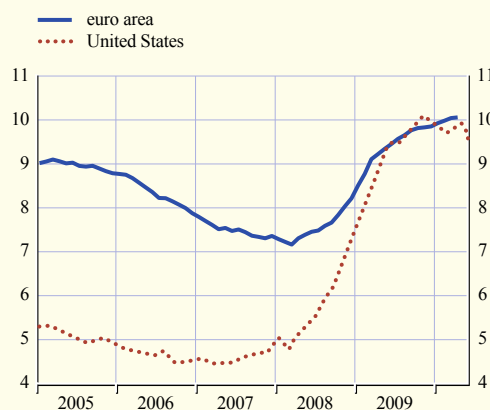
4 See the box entitled "Recent labour supply developments" in the June 2010 issue of the Monthly Bulletin.

sharp fall in the participation rate, as many workers have been discouraged from seeking work by reduced employment prospects, while US population growth moderated only slightly.

The different reactions in employment and labour force dynamics in the two economies have led to a much slower increase in registered unemployment in the euro area – albeit from a higher initial level. Thus, in the euro area, the unemployment rate rose from the March 2008 low of 7.8% to 10.0% by the end of May 2010 (see Chart B). Meanwhile, the jump in the US unemployment rate has been considerably greater, having more than doubled from 4.8% in February 2008 to a peak of 10.1% in October 2009.

**Chart B Unemployment rate**

(percentages of the labour force)



Sources: Eurostat, the US Bureau of Labour Statistics and ECB calculations.

There are a number of reasons which may help to explain the lower employment losses observed thus far in the euro area relative to the United States. These include the earlier onset of the downturn in activity in the United States compared with the euro area, as well as the greater exposure of the US economy to sectoral shocks in the construction, real estate and financial sectors. In part, they may also stem from differences in definitions (with the United States counting the numbers of jobs held, whereas euro area data reflect the numbers of persons employed); but disparities in definitions alone cannot explain the very large increase observed in US unemployment. Part of this divergence can be understood in terms of the heavier reliance on reductions in working hours as the main means for adjusting employment in many euro area countries.<sup>5</sup> In several euro area countries, these measures were also supported by government subsidies. Such policies were broadly welcomed by firms anxious to retain skilled workers – particularly in those countries where skills shortages had been observed in the years preceding the recession. Finally, the stronger employment protection legislation in the euro area is also likely to have played an important role in delaying the labour market adjustment to what was initially perceived in many euro area economies as being to some extent a temporary disruption to demand.

### Policy implications

Both economies' labour markets appear to have shown signs of stabilisation in recent months (with euro area unemployment levelling off and US unemployment slightly down from its October 2009 peak). However, it is likely to be some time before employment growth picks up substantially. It will be necessary to ensure that the recent deterioration in labour markets does not lead to higher structural unemployment. Longer-term improvements – and future employment growth – are likely to depend heavily on the ability of the economies to reorganise and restructure in the face of major sectoral shifts.

<sup>5</sup> The use of short-time working programmes in many euro area countries increased sharply during the recession (applying, at its peak, to around 4% of employees in Germany and Italy), whereas similar schemes applied to only around 0.5% of the US labour force. See IMF, *World Economic Outlook*, Chapter 3, "Unemployment Dynamics during Recessions and Recoveries: Okun's Law and Beyond", 2010.

For the euro area, this process of restructuring is likely to require further reforms in both labour and product markets to enhance activity and thereby employment prospects. Further structural reforms and a timely dismantling of crisis policy measures – including the continuing reliance on subsidised short-time working schemes in some countries – will facilitate the reallocation of labour to more productive sectors. In this respect, an easing of employment protection legislation for permanent workers would, in several countries, help to alleviate some of the existing labour market dualism and encourage rehiring. Efforts to enhance wage flexibility – allowing for sufficient differentiation to reflect local labour market conditions, firms’ competitive situations and local productivity levels – would help to address remaining imbalances and further stimulate labour demand. In product markets, enhanced competition would foster innovation and the implementation of efficient working practices.