

Box 7

LABOUR MARKET DEVELOPMENTS IN THE EURO AREA AND THE UNITED STATES SINCE THE BEGINNING OF THE GLOBAL FINANCIAL CRISIS

This box provides an overview of differences in labour market adjustments in the euro area and the United States since the beginning of the global financial crisis. It presents some stylised facts on a number of key labour market indicators, including the unemployment rate, the labour force participation rate and labour cost developments.

Unemployment and employment trends

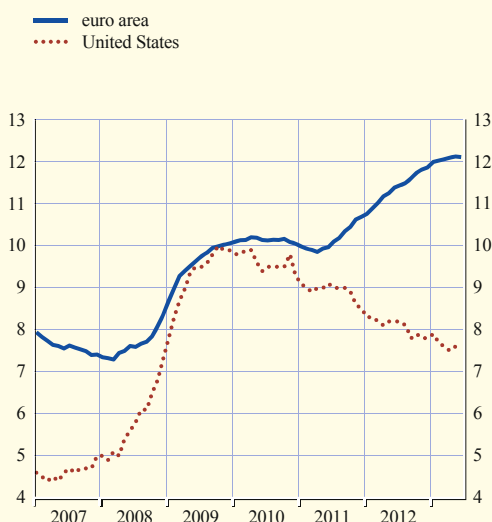
In the two years following the start of the economic crisis in 2007, the labour market in the United States deteriorated very quickly and the pace of adjustment was more substantial than in the euro area (see Chart A). Labour hoarding practices in euro area labour markets during the initial phase of the crisis contributed to mitigating employment adjustment (see Chart B), as firms showed a widespread preference for forms of internal flexibility, such as cutting overtime and making use of short-time working schemes.

Over recent years, however, unemployment rates in the two regions have diverged substantially, reflecting significant differences in real GDP growth. Since mid-2010, employment growth has turned positive and the unemployment rate has decreased markedly in the United States. In the euro area, the opposite has been observed. As a result, the gap between the two unemployment rates has increased continuously. In June 2013 the unemployment rate for the euro area was 12.1% and that for the United States was 7.6%.

In the initial phase of the crisis the statistical relationship between economic growth and the unemployment rate in the euro area deviated significantly from its longer-term trend. This was owing to a strong reliance on short-time working schemes in some euro area countries. However, subsequent aggregate unemployment developments in the euro area started to be more broadly in line with typical patterns, meaning that unemployment became more sensitive to changes in real GDP after the initial period of labour hoarding, and weak

Chart A Unemployment rate

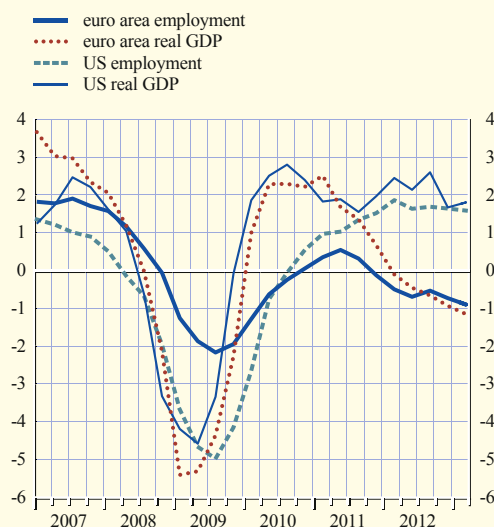
(percentage of the labour force; seasonally adjusted data; monthly data)



Sources: BLS and Eurostat.

Chart B Employment and real GDP growth

(year-on-year percentage changes; quarterly data)



Sources: BLS and Eurostat.

economic activity was increasingly reflected in a higher unemployment rate. By contrast, in the United States, the stronger labour market adjustment in the initial phase of the crisis and the stronger rebound in employment once economic growth resumed were more in line with historical patterns.

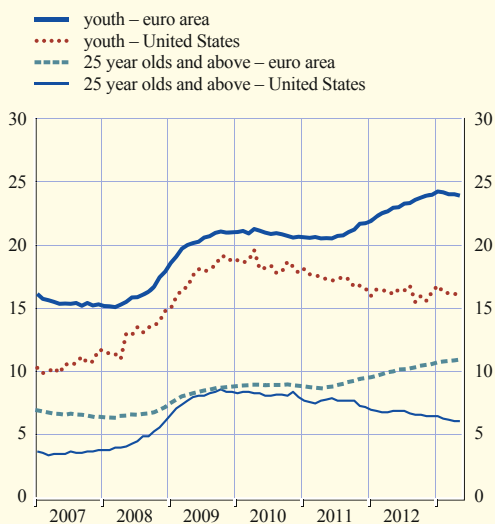
Unemployment breakdown by age and duration

Younger workers have been particularly hit by the crisis in both regions, but in the United States, unlike in the euro area, the youth unemployment rate has been declining (see Chart C). Developments in the unemployment rates in the euro area and the United States classified by age cohorts (“youth” and “above 25 years”) follow a broadly similar trend to the total unemployment rate. Overall, the youth unemployment rate in the euro area increased on average from 15.5% in 2007 to 23.9% in June 2013, while in the United States it increased from 10.6% to 16.3%.

In the euro area, the share of those unemployed for more than a year initially decreased, but since 2009 this trend has reversed (see Chart D). The initial fall partly reflected the rise in short-term unemployment at the beginning of the crisis. In the United States, by contrast, the crisis initially resulted in a large increase in the share of long-term unemployed. This rise could be linked to an extension of the duration of unemployment benefit introduced in 2008, which increased incentives for individuals to remain unemployed. According to IMF estimates, structural unemployment (the non-accelerating inflation rate of unemployment – NAIRU) in the euro area stood at 10.1% in 2012, up from 7.4% in 2007. In the United States, the increase in structural unemployment was smaller over the same period (6.1% in 2012, up from 5.0% in 2007). These differences imply that a large part of the rise in euro area unemployment is structural, while in the United States it is interpreted as being mostly cyclical. Based on these

Chart C Unemployment rate breakdown by age

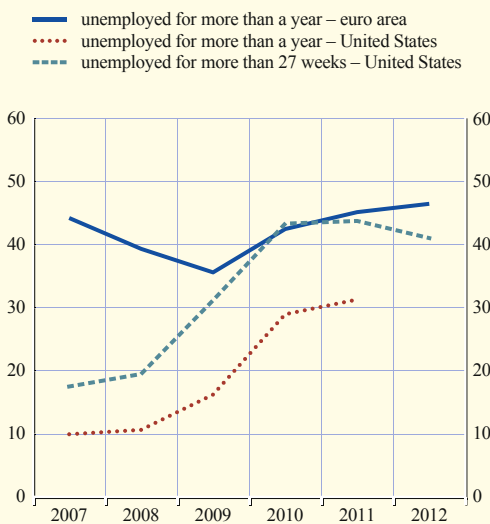
(relative to the labour force; seasonally adjusted data; monthly data)



Sources: BLS and Eurostat.
Note: The youth unemployment rate refers to 15-24 year olds in the euro area and to 16-24 year olds in the United States.

Chart D Share of long-term unemployment

(relative to total unemployment; annual data)



Sources: OECD, Eurostat and BLS.
Note: The share of long-term unemployment is defined in the United States as those that are unemployed for over 27 weeks or more than one year relative to the total unemployed, and in the euro area as those that are unemployed for more than a year relative to the total unemployed.

estimates, since 2007 almost two-thirds of the rise in the unemployment rate is thus considered to be structural in the euro area, compared with one-third in the United States.

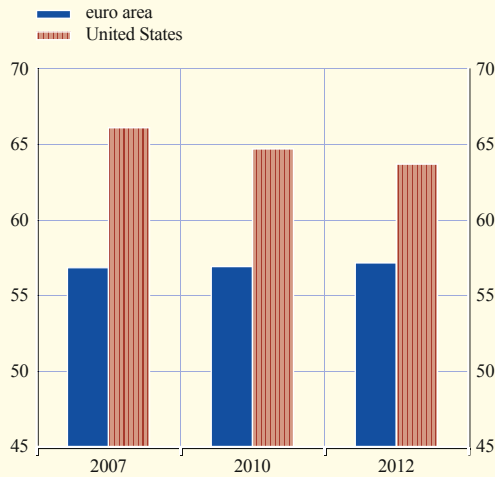
Labour force participation developments

The difference in euro area unemployment developments relative to the United States also reflects very different developments in labour market participation (see Chart E). One of the most notable features of the crisis is that the participation rate increased in the euro area. This reflected the ongoing trend of rising female participation in the euro area (see Chart F). By contrast, in the United States, the participation rate declined significantly between 2007 and 2012.

Over the period 2010-12, the decline in the participation rate contributed significantly to the fall in the unemployment rate in the United States. At the same time, the rising participation rate in the euro area explains part of the rise in the unemployment rate. Assuming that, in both the United States and the euro area, the labour force participation ratios had remained unchanged compared with 2007 and that the difference to the actual ratios had been fully reflected in the number of unemployed, the US unemployment rate in 2012 would have been higher than that of the euro area. The diverging participation rates between the euro area and the United States indicate that there has been a significant amount of labour market slack in the United States that has not been fully captured by unemployment rate developments.

Chart E Total labour force participation rate

(relative to the "15/16 years and over" populations)

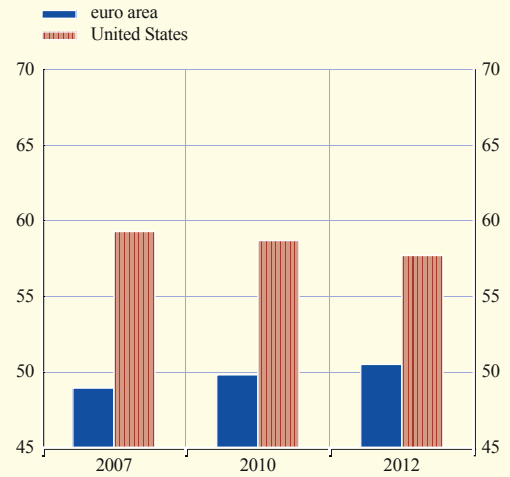


Sources: BLS and Eurostat.

Note: The labour force participation rate was computed for the "15 years and over" population for the euro area and the "16 years and over" population for the United States.

Chart F Female labour force participation rate

(relative to the "15/16 years and over" female populations)



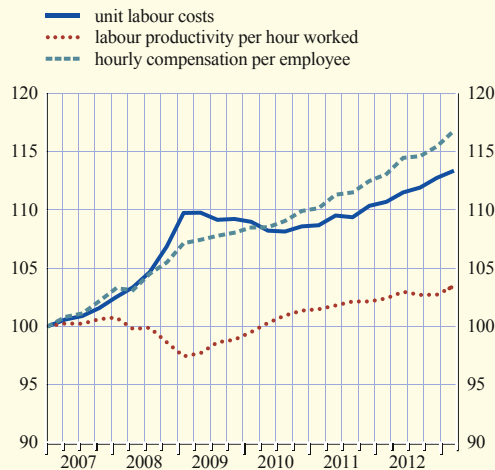
Sources: BLS and Eurostat.

Labour cost developments

Between the first quarter of 2007 and the first quarter of 2013, unit labour costs in business sectors grew significantly more in the euro area than in the United States (see Charts G and H).

Chart G Unit labour cost developments in the euro area business sector

(Q1 2007 = 100; quarterly data)

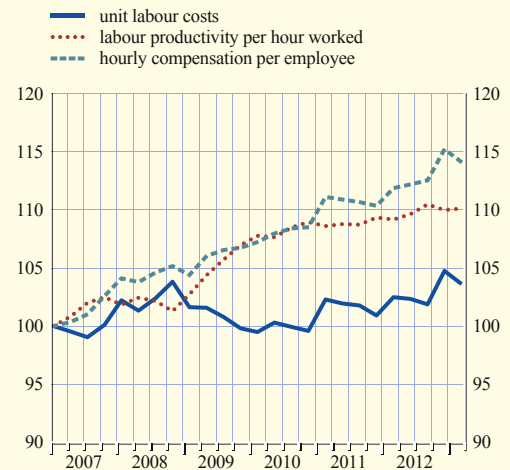


Sources: Eurostat and ECB calculations.

Note: Business sector in the euro area is defined as the total economy, excluding public administration and defence; compulsory social security; education; human health and social work activities.

Chart H Unit labour cost developments in the US non-farm business sector

(Q1 2007 = 100; quarterly data)



Source: BLS.

These developments mainly reflected lower hourly labour productivity growth in the euro area, but also somewhat higher growth in hourly compensation per employee than in the United States.

Major labour hoarding in the initial phase of the crisis and a lack of adequate restructuring in a context of contracting economic activity, weighed on the labour productivity growth performance of the euro area. At the same time, in the United States, wage developments closely followed labour productivity performance, whereas in the euro area wage growth was decoupled from productivity developments.

To sum up, there are several factors behind the different performances of the labour markets in both regions since the beginning of the crisis. Overall, the more flexible labour market in the United States led to faster and stronger labour market adjustments to the initial downward shocks and was coupled with more moderate unit labour cost developments than in the euro area. This, in turn, may have contributed to facilitating economic adjustment and restructuring and may have been one reason why, since 2010, economic activity has begun to develop significantly more favourably in the United States than in the euro area. Beyond the need for strengthening structural reforms in the euro area to boost competition and productivity, this highlights the need for labour market reforms to ensure that euro area wages respond more flexibly and appropriately to labour productivity and employment developments in the future.