

# Developments in and structural features of the euro area labour markets

*The rate of unemployment remains high in the euro area, at around three times the level recorded in the early 1960s. The analysis of patterns of employment, non-participation in the labour force and unemployment summarised in this article reveals significant differences between the euro area and the United States. There has been a trend decline in the employment rate and a rise in the unemployment rate in the euro area over the past 40 years. Labour market problems appear to be concentrated among certain groups in society, such as women, younger and older workers and the low skilled, while the position of prime-age men (those aged between 30 and 59 years) appears to be broadly comparable between the euro area and the United States. There is a significant regional dimension to unemployment within some euro area countries and a serious problem of long-term unemployment across the euro area.*

*The problems of the euro area labour markets may be linked to a number of structural factors relating to work incentives, excessive labour costs, skills-based and geographical mismatches, government regulations and long-term exclusion from the labour market. A wide range of policy measures, which are also touched upon in this article, exists for dealing with such problems. Over the past few years, the European Union (EU) has redoubled its efforts to promote decisive structural reforms aimed at improving the functioning of labour markets. However, the implementation of such reforms is primarily a matter for national governments and the social partners, and the reforms needed depend on the specific nature of the labour market problem in each country. A significant and sustained reduction in euro area unemployment will require further substantial structural improvements in the functioning of the labour market.*

## I Introduction

Despite recent falls, unemployment in the euro area remains around three times as high as the level observed in the early 1960s. To understand the causes of the secular rise in unemployment and the measures that could be taken to ensure that the recent decline is sustained, it is important to examine the performance of the euro area labour markets in detail, focusing in particular on patterns of employment and non-participation. In this context, it is worthwhile breaking down the working age population into three component parts: employed, non-participating and unemployed (as outlined in Box 1). Selected comparisons with the United States are also used as a point of reference.

Employment, as indicated in Chart 1(a), accounted for 64.6% of the total working age population in the euro area in 1960, i.e. 3.6 percentage points above the level in the United States. Subsequently, the employment rate in the euro area fell to 59.4% in 1999, while it steadily increased in the United States, with a significant acceleration from 1984 onwards, reaching

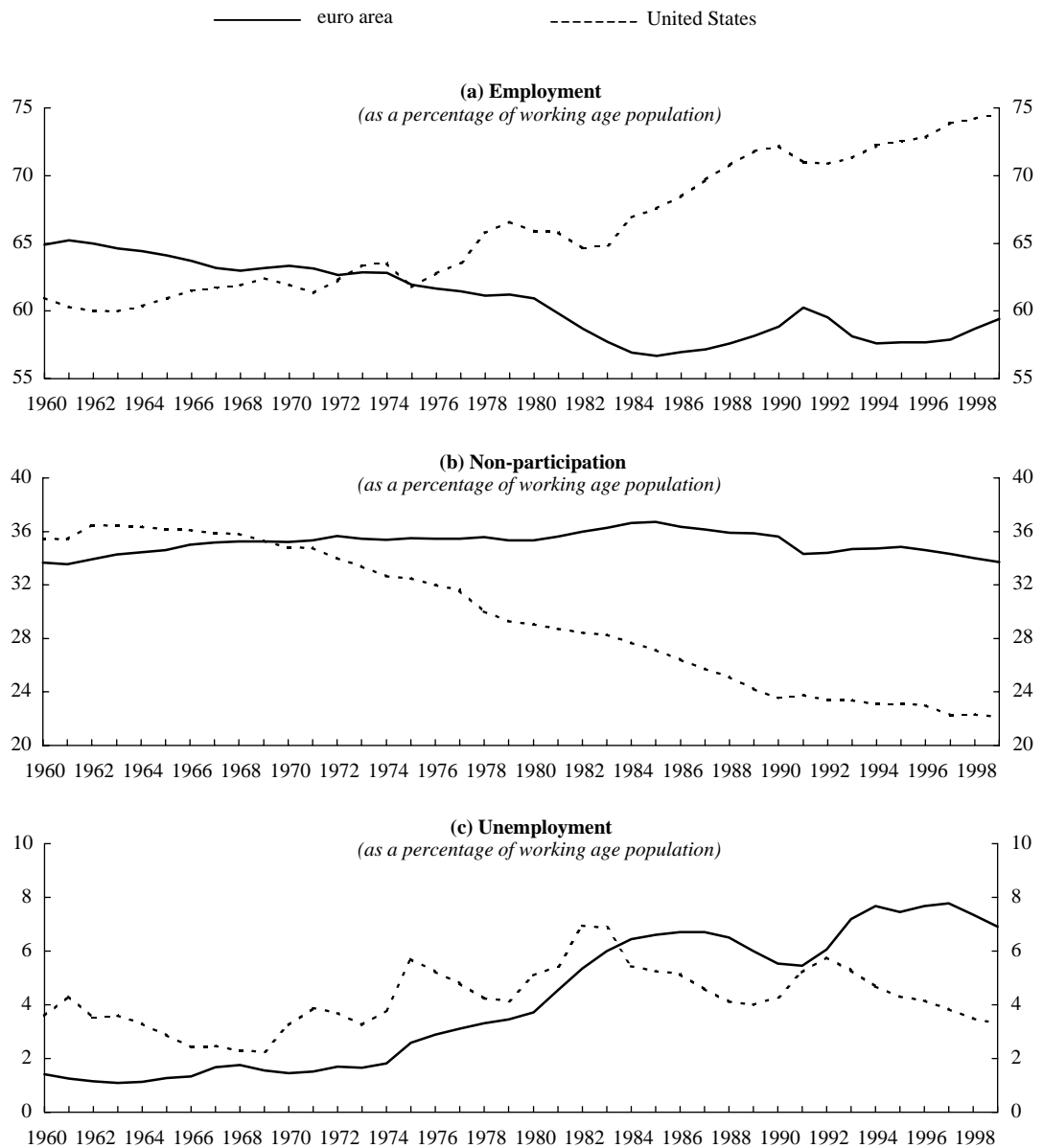
74.6% in 1999. In the United States, the rise in employment was associated with a marked increase in labour force participation (see Chart 1(b)).

A similar pattern can also be seen for unemployment, as shown in Chart 1(c). In 1960 a mere 1.4% of the population of working age in the euro area was unemployed. The proportion of the working age population that was unemployed then increased steadily, most markedly after 1975, but remained below the corresponding US figure until 1984. Since then, unemployment as a share of working age population has been consistently higher in the euro area than in the United States and reached 6.9% in 1999. By contrast, on the other side of the Atlantic, in 1999 only 3.3% of the working age population was unemployed, little changed from 1960, despite a temporary peak of 7.0% in 1983.

By contrast with previous upturns, during the two periods of economic expansion, from 1985 to 1991 and from 1996 to the present, the employment rate in the euro area

## Chart I

### Breakdown of working age population in the euro area and the United States: 1960-99



Source: OECD.

Note: The euro area employment rate and non-participation rate do not include Austria and France from 1960 to 1964 and the Netherlands from 1960 to 1968. The euro area unemployment rate does not include Austria from 1960 to 1964 and Luxembourg from 1960 to 1973. The 1999 euro area aggregate does not include Finland, Luxembourg, Ireland and Portugal. See Box 1 for further details.

increased and this was associated with some decline in unemployment. Indeed, the further increase in unemployment in the 1990s was matched by a modest rise in labour force participation from the mid-1980s, rather than

a further decline in the employment rate, which was the dominant factor in the earlier period. To the extent that data are available, these trends are analysed in more depth in the remainder of this article.

## Box I

### Analysing labour market developments

There is no single framework for analysing developments and features in the labour market. In recent years an increasingly popular approach in the relevant literature has been to consider labour market changes in terms of flows. In this context, unemployment can be seen as a combination of the duration of unemployment and the probability of being unemployed, which is linked to the flow of workers in and out of the labour market. Within such a framework, the longer the duration and the lower the flows, the higher the level of unemployment. A number of studies comparing national labour markets in euro area countries with the US labour market suggest that worker flows are much higher in the United States. These studies also argue that this result relates to greater job security in the euro area labour markets. However, owing to the unavailability of comparable data on flows at the area-wide level, it was not possible to adopt such a framework for analysis in this article.

Instead, this article focuses on the analysis of the working age population (i.e. people between 15 and 64 years of age) which is broken down into its three broad components – employed, non-participating and unemployed. The simple framework used in the introductory part of this article, with data from the OECD, is informative as it removes the effects of rising populations, which is important when comparing developments in the euro area with those in the United States. Moreover, this makes it possible to pinpoint clearly the role played by changing employment and labour force participation in the development of unemployment in the euro area. Undertaking such an exercise over a longer period also removes the possibility that cyclical macroeconomic developments might be the dominant cause of the observed developments. In the main body of the article, employment, non-participation and unemployment are analysed in more depth, using data from the labour force surveys for the euro area as outlined below.

#### Definitions and data used

Standard ILO definitions are utilised in this article with the exception of the introductory part, the latter being based on OECD data which are not fully consistent with ILO definitions.

- Employed persons include all persons who performed any work at all during the reference period, whether for pay or for profits, or were temporarily absent from a job, for such reasons as illness, holidays or industrial dispute.
- Unemployment comprises all persons without work, seeking work during the reference period and actually available for work.
- The labour force is the sum of the number of persons employed and the number of persons unemployed, while non-participants are those working age people not included in the labour force.

With regard to the data, three sources are used: the labour force survey compiled by Eurostat, the OECD Labour Force Statistics and the US Bureau of Labor Statistics.

- Every year since 1983 labour force surveys have been carried out in the spring in the Member States of the EU and have been compiled by Eurostat. There is no information available for euro area countries before they joined the EU (i.e. for Spain and Portugal prior to 1986, Austria and Finland prior to 1995). Therefore, euro area data prior to 1995 have been estimated excluding these missing countries where necessary. The Eurostat labour force survey has evolved since 1983, with the introduction of more detailed questionnaires and, most notably, the major changes which occurred in 1991. Therefore some series are only available after 1991 (types of contracts, sectoral breakdown, age group breakdown, etc.). At the cut-off date for this issue of the ECB Monthly Bulletin some detailed data were not yet available from the 1999 labour force survey. Unless otherwise stated, the euro area figures mentioned in Sections 2, 3 and 4 of this article are labour force survey data.

- The OECD has been maintaining a database of labour market data collected from national surveys. This database is useful for carrying out long-term analysis, as the data go back to the early 1960s, as illustrated in the first part of the article.
- With regard to the United States, when OECD data were not available, data from the US Bureau of Labor Statistics were compiled on the most comparable basis possible.

Constraints on data availability mean that it is not always possible to adopt the same time horizon for the series analysed in this article. Finally, the tables and charts do not contain all the data referred to in the article. Those which do not appear can be found in the data sources indicated above and are available upon request.

## 2 Employment developments in the euro area

Employment in the euro area stood at around 117 million persons in the second quarter of 1999. As discussed in the previous section, the employment rate has remained broadly stable, at around 60% of the working age population since the middle of the 1980s, by marked contrast with the United States where there has been a prolonged upward trend in employment. However, the employment situation varies significantly within the countries of the euro area. In the Netherlands, Austria, Portugal, Germany and Finland, employment rates are between 60% and 70%. In Luxembourg, Ireland, France and Belgium, employment rates are close to 60%. In the remaining two countries, Italy and Spain, the employment rate is around 50%. Moreover, these aggregate statistics mask significant differences in developments in the various sub-categories of employment.

### **Employment rates are low among females, the young and the unskilled**

In 1999 the female employment to population ratio was 18 percentage points lower in the euro area than it was in the United States, while the difference between the male employment rates was 12 percentage points. However, since the end of the 1980s the female employment rate has been increasing in the euro area, while the male employment rate has been falling gradually. As a result, the difference between US and euro area gender employment rates has tended to

widen for men but has remained broadly stable for women. At the level of individual euro area countries, although there are differences between the employment rates for both men and women, there is more variability in the female employment rates.

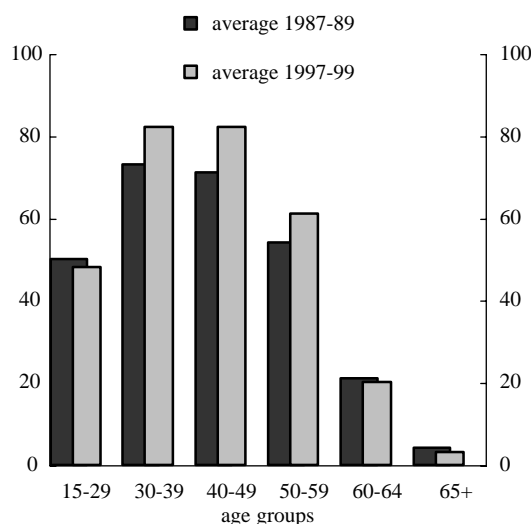
Disaggregating employment rates by age for the euro area, reveals an increase for prime-age workers (those aged between 30 and 59 years), and a fall among the young (15 to 29 years) and the old (over 60 years) in the past 15 years. These developments are shown in Chart 2, which presents a comparison of employment rates by age groups between the end of the 1980s and the end of the 1990s. The reduction in employment rates among the young may be, in part, the result of an increase in the length of formal education. Among older workers, it may be linked to the implementation of early retirement programmes in many countries. It is noteworthy that early retirement schemes have frequently been used as a short-term solution to job destruction in declining industries. However, more recently some of these schemes have been used to encourage the transfer of work from older to younger workers, based on the assumption that this would improve the employment prospects of young people.

In recent years job creation has led to an increase in the share of highly skilled workers and a decline in the share of low skilled workers. In 1997, the most recent year for which the data are available, around 23% of

## Chart 2

### Employment rates by age groups in the euro area

(as a percentage of the total population in each age group)



Source: Eurostat.

Note: Data prior to 1994 are ECB estimates.

the employed between 25 and 59 years of age underwent tertiary education, compared with around 20% in 1992. At the same time the proportion of people undergoing lower secondary education or less fell from 43% in 1992 to 33% in 1997. These developments are partly explained by the increase in the average level of education of the total population, but at the same time they also reflect differences in employment prospects for these workers. In 1997 more than 80% of highly skilled people had a job, compared with less than 60% of the low skilled. Employment developments by occupation have moved in the same direction, showing an increasing proportion of, for instance, “managers and highly skilled professionals” compared with a smaller proportion of low skilled job categories such as “elementary operators”.

### Sectoral composition of employment moving towards services

In common with the United States, there has been a secular trend in the euro area towards a more service-based economy (see Table 1),

but there are important differences. First, despite a continued reduction, the proportion of employment in the agricultural sector in the euro area is around twice as high as it is in the United States (5.1% and 2.7% respectively in 1998). Second, the industrial sector has a larger employment share in the euro area than in the United States (30% and 24% respectively). Finally, while employment in the services sector has increased by around 15 percentage points in the euro area since 1978, it remains well below that of the United States (64% and 74% respectively). This difference could be partly a result of the slower, albeit accelerating, pace of liberalisation in the euro area economy, together with the larger administrative burden associated with the creation of new firms, which may have held back the development of the services sector. In addition, rigid wage structures in the euro area may have hampered the creation of jobs with low productivity, which represent a large share of employment potential in services. The difference in employment shares in services between the euro area and the United States is reflected in the shares of output, indicating that lower employment in services in the euro area is not a consequence of higher productivity but rather of the smaller size of the services sector.

**Table 1**  
Employment distribution by sector of activity

(as a percentage of total civilian employment)

	1978	1998
Euro area		
Agriculture	11.8	5.1
Industry	38.8	30.4
Services	49.4	64.5
United States		
Agriculture	3.7	2.7
Industry	31.1	23.6
Services	65.2	73.7

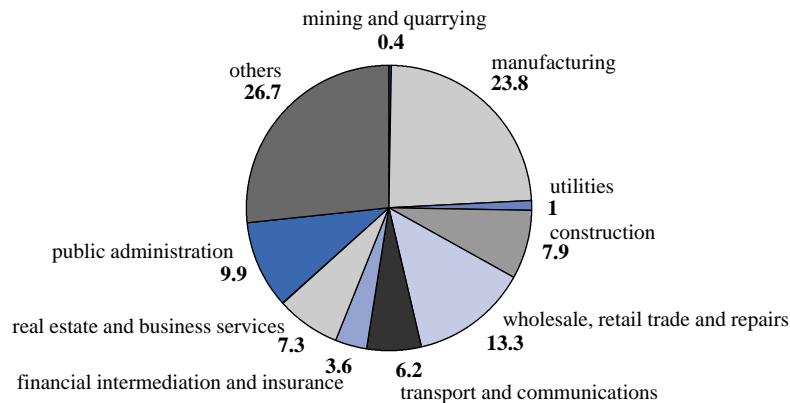
Source: OECD.

### Chart 3

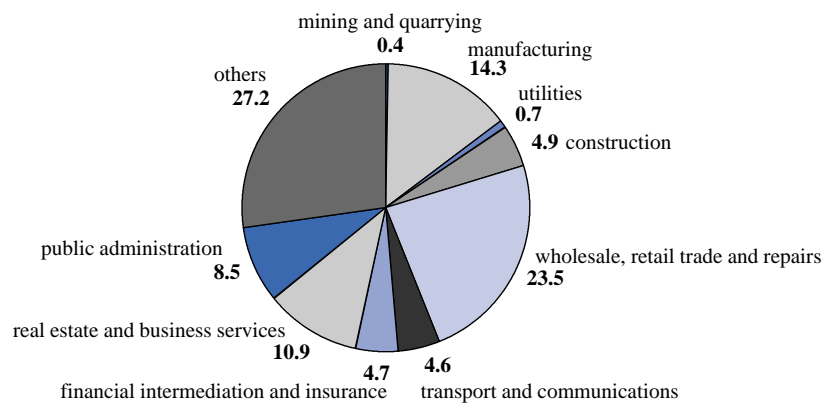
#### Sectoral distribution of employees in 1999

(as a percentage of total employees on non-farm payrolls)

##### Euro area



##### United States



Sources: Eurostat and the US Bureau of Labor Statistics.

A more detailed examination of the sectoral distribution of total employees on non-farm payrolls, presented in Chart 3, shows that the difference in the respective size of the industrial sector is largely attributable to manufacturing, which amounted in 1999 to 23.8% in the euro area compared with 14.3% in the United States. However, it is important to emphasise that this may be partly related to the larger outsourcing process that has taken place in the United States by comparison with the euro area. In the employment statistics, outsourcing has shifted some types of employment from manufacturing to services. It affects both the highly skilled, for example those employed in IT-related work, and low skilled workers, for example in cleaning services. Within the services sector, it is notable that the share of

employment in wholesale, retail trade and repairs is higher in the United States. This may be partly linked to restrictions on opening hours in Europe and also to difficulties in employing low skilled workers owing to high labour costs and inappropriate wage structures. Against this background, gains in employment from further liberalisation appear possible in the euro area, in particular in services.

#### Increasing part-time employment

An important element of job creation in the euro area in recent years has been the growth of part-time employment. Indeed, from 1995 to 1999 part-time employment rose from 14.2% to 16.7% of total employment and this

increase was equivalent to more than half of overall net job creation. In recent years there have been several initiatives in euro area countries aimed at promoting this type of contract. These include the introduction of less rigid regulations on working time arrangements and specific incentives provided by means of reductions in social security contributions.

In the euro area three groups of countries can be distinguished according to the importance of part-time employment. The Netherlands, where around 40% of people in employment and 70% of women have part-time contracts, is clearly in a league of its own. The second group includes Germany, France, Belgium, Austria and Ireland, where the part-time employment rate is around 15%. Finland, Portugal, Spain, Italy and Luxembourg form the third group, with a rate around or below 10%. In general, with the exception of the Netherlands, the differences between countries mainly reflect differences in the part-time employment rate for women. At the sectoral level, services have the highest part-time ratio (20%), followed by agriculture (16%) and industry (6.5%).

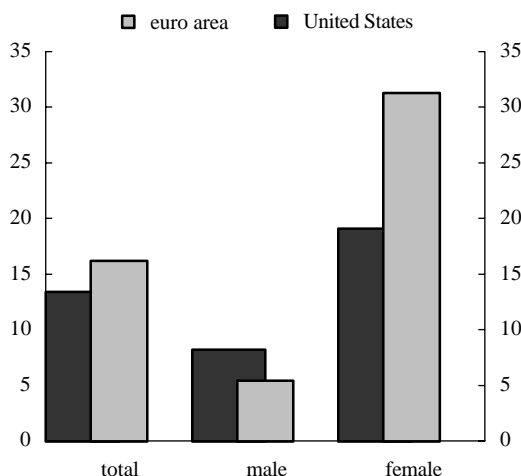
The proportions of part-time employment in the euro area and the United States are quite similar, although in the United States it has remained stable at this level for some years. Furthermore, it is noteworthy that although more women than men work part time in both the United States and the euro area, the difference is greater in the euro area (see Chart 4).

#### Rising proportion of temporary contracts

Temporary employment has increased in recent years in the euro area, reaching 14.9%

**Chart 4**  
**Part-time employment in 1999**

(as a percentage of total employment)



Sources: Eurostat and the OECD.

Note: US data refer to 1998.

of total employees in 1999 compared with 13.2% in 1995. Although the ratio is broadly the same for both men and women, there are big differences across countries. Spain has the highest temporary employment rate, at over 30%, although in the past few years this figure has fallen slightly. Italy, Belgium and Austria – with a temporary employment rate of around 8% – are at the lower end of the spectrum, while the remaining countries have rates close to 15%. Although the use of temporary contracts undoubtedly has benefits for firms in terms of flexibility, it should be recognised that a substantial use of temporary employment could be an indicator of rigid job protection regulations, which make firms reluctant to hire on a permanent basis. It is noteworthy that the use of forms of temporary employment tends to be much lower in countries with less stringent job protection laws, such as the United States and the United Kingdom, although it has also risen in these countries in recent years.

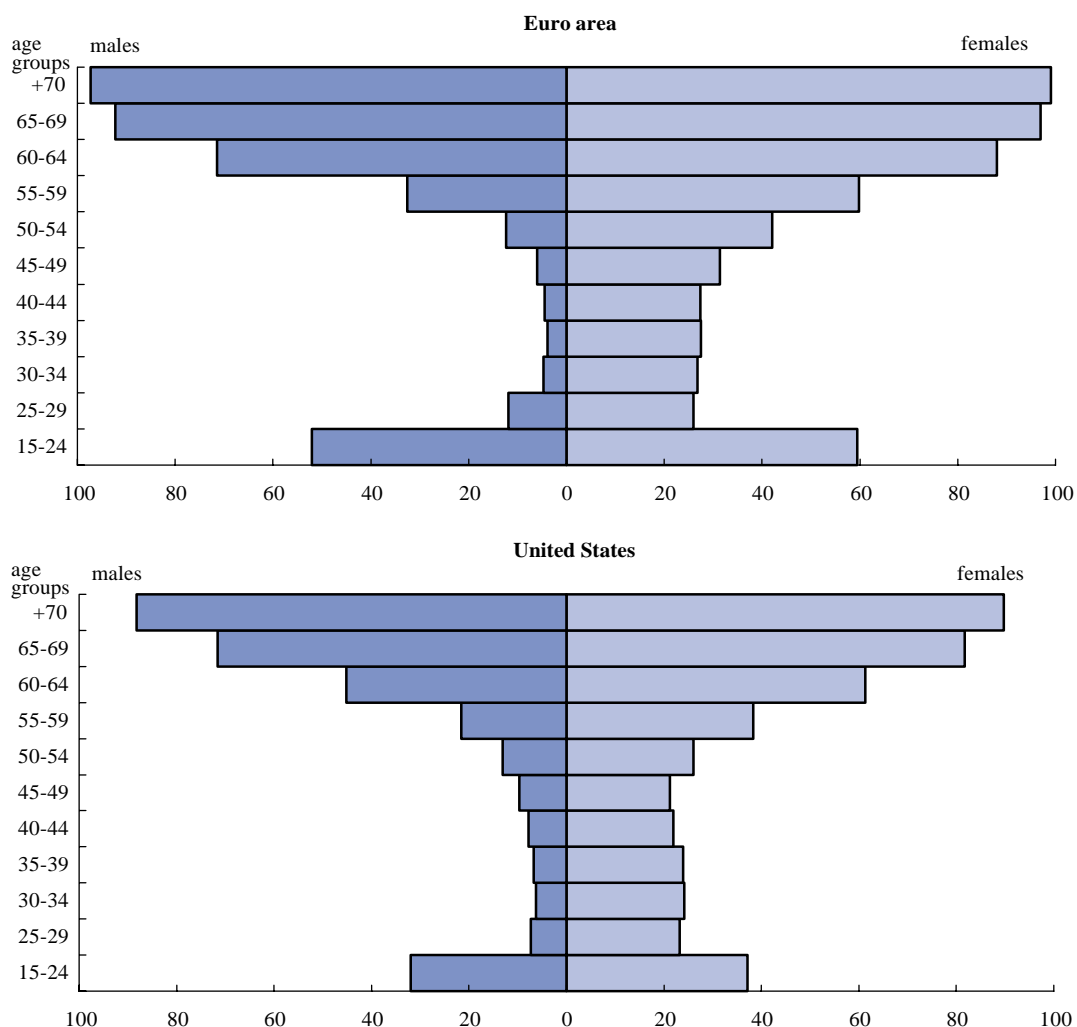
### 3 High levels of labour force inactivity in the euro area

As highlighted in Section I, since the 1960s non-participation rates, or labour force “inactivity” rates, within the euro area have changed very little compared with the continuous and rapid decline in inactivity in the United States. An analysis of the various sub-categories of inactivity reveals that prime-age male workers display broadly similar rates of labour force inactivity on both sides of the Atlantic, although the rates are slightly higher in the United States (see Chart 5). However, substantial differences exist for young people, prime-age women and older people, where

the level of non-participation is much higher in the euro area.

Comparisons of the structure and evolution of non-participation across countries tend to suggest that, over the long run, labour force participation is influenced by labour market conditions as well as institutional incentives and cultural factors. High levels of unemployment can discourage the inflow of workers, notably women, into the labour force. Institutional incentives that encourage inactivity, especially among younger and older

**Chart 5**  
**Non-participation in the labour force in 1999 in the euro area and in the United States**  
*(as a percentage of total population)*



Sources: Eurostat and the US Bureau of Labor Statistics.



workers, have sometimes been seen as a way in which to reduce recorded unemployment.

### Young people take longer to enter the labour force

Since the beginning of the 1980s the euro area has witnessed a substantial rise in inactivity among young people, affecting males and females equally. In 1999, while a little more than a third of young Americans were inactive, over half of young Europeans had delayed their entry into the workforce. The non-participation rate for those aged 15 to 24 years rose from 49.0% in 1983 to 55.7% in 1999 (see Chart 6). Each euro area country recorded a similar trend, with the exception of the Netherlands, where the participation rate of young people is higher than it was in 1983. This might be partly a result of a significant cut in the youth minimum wage in the early 1980s, which enhanced youngsters' employability. Recently the Netherlands has also embarked on far-reaching reforms of labour market policies, notably favouring early and compulsory activation of the young unemployed. The other member countries,

in particular Portugal, France and Luxembourg, have registered a rapid rise in inactivity among the young.

This trend has to be seen against the background of significant increases in enrolments in education and training. Young people tend to delay their entry into the workforce in order to gain further qualifications and thereby improve their future job prospects. However, recent studies have drawn attention to the concentration of economic and social problems among a "core" disadvantaged group of youth. In 1999 around a fifth of all young people aged between 18 and 24 in the euro area were without work, not in education and with limited educational achievements. This group, mostly consisting of young males, accounted for more than 30% of the population aged 18 to 24 years in Portugal, Italy, Luxembourg and Spain.

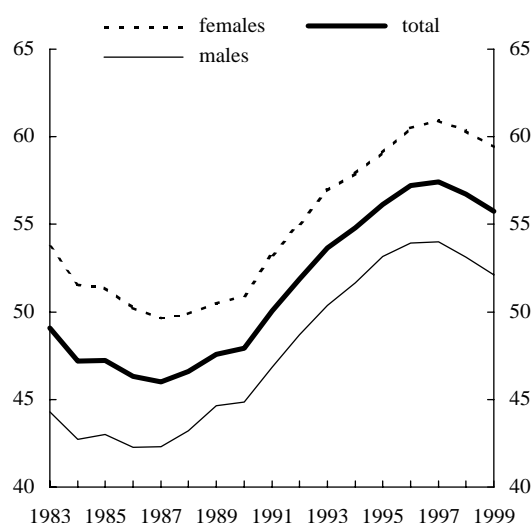
### Marked increase in female participation in the labour force

There has been a secular rise in female participation in the labour force in both the euro area and the United States since World War II. This reflects long-run economic and social forces leading to more women participating in the labour force. This tendency has markedly reduced the average non-participation rate for European women aged 25 to 54 years old, from more than 45% in 1983 to 29.7% in 1999 (see Chart 7). Over the same period, the equivalent US inactivity rate also declined from 38.0% to 23.2%. Therefore, European women between 25 and 54 years of age still tend to participate in the labour market less than their American counterparts, although the gap is diminishing rapidly.

In Europe the greatest increases have clearly been recorded in countries where female employment has traditionally been low, such as Spain, the Netherlands and Ireland, where female inactivity has fallen by more than 40 percentage points since 1983. Greater flexibility in working time arrangements, such as the development of part-time work, is

**Chart 6**  
Inactivity rates in the euro area:  
population aged 15 to 24

(as a percentage of the total population aged 15 to 24)

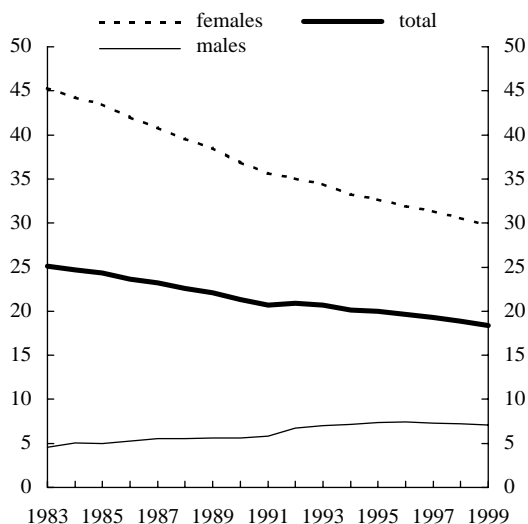


Source: Eurostat.

Note: Data prior to 1994 are ECB estimates.

**Chart 7**  
**Inactivity rates in the euro area:**  
**population aged 25 to 54**

(as a percentage of the total population aged 25 to 54)



Source: Eurostat.  
 Note: Data prior to 1994 are ECB estimates.

likely to have played a role, most notably in the Netherlands.

By comparison, prime-age male inactivity steadily increased over the same period. The average inactivity rate for prime-age males in the euro area labour force rose from 4.6% in 1983 to 7.1% in 1999. This development conceals significant national differences. In Italy the non-participation rate of prime-age men virtually doubled between 1983 and 1999 (from 4.3% to almost 10%), while inactivity among Dutch men remained broadly constant at around 7%.

**Older workers still retire early**

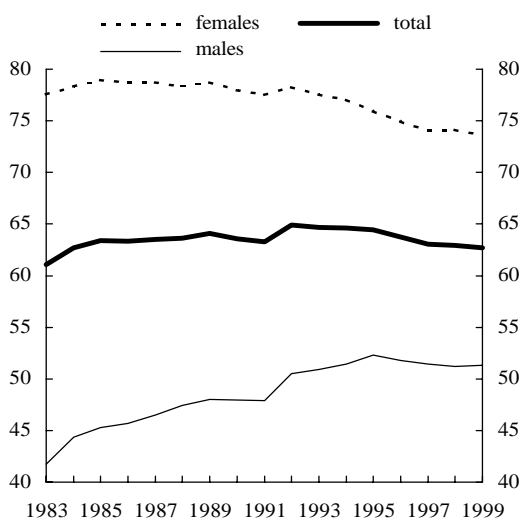
Over the past two decades inactivity rates for older male workers have substantially increased in the euro area. Despite a standard age of retirement set at 65 in the vast majority of euro area countries, inactivity rates for male workers aged 55 to 64 rose from 42% in 1983 to 51% in 1999 (see Chart 8). By comparison, over the

same period the equivalent rate of non-participation in the US labour force rose by 2 percentage points to stand at nearly 32% in 1999.

Older workers in the euro area withdraw from the labour force sooner than they do in the United States. By the age of 60, half of European workers have already withdrawn from the labour force while only around a third of American workers have ceased to be active. The gap is even wider for the 60 to 64 age group (26.7 percentage points). This trend reflects a clear tendency towards earlier withdrawal from the labour force, supported by increased institutional incentives to retire early. Most euro area countries have implemented early retirement schemes, from as early as the age of 56 or 57 in Portugal and France under specific circumstances. Inactivity rates for older women tell a different story, as they remained broadly stable or even declined in most countries over the same period, so that a growing proportion of women aged 55 to 64 have remained in the labour force since the beginning of the 1980s.

**Chart 8**  
**Inactivity rates in the euro area:**  
**population aged 55 to 64**

(as a percentage of the total population aged 55 to 64)



Source: Eurostat.  
 Note: Data prior to 1994 are ECB estimates.

Although rising inactivity rates among older male workers partly reflect institutional incentives, such as relatively generous pension benefits, they are also indicative of an employability problem faced specifically by older workers. There is evidence that early retirement is mainly concentrated among those previously employed in slow-growing

sectors, such as manufacturing, mining or construction and among those with low levels of qualifications. Those in the latter group are also less likely to receive training than more educated workers and are likely to have greater difficulty in adapting to changing job requirements. This might contribute to their early withdrawal from the labour force.

#### 4 High unemployment in the euro area

As discussed in Section I, unemployment has increased over time in the euro area by contrast with the United States where it has shown no upward trend. However, it is useful to examine various sub-categories of unemployment, which can exhibit quite different patterns.

##### High unemployment mostly concentrated among women, the young and the low skilled

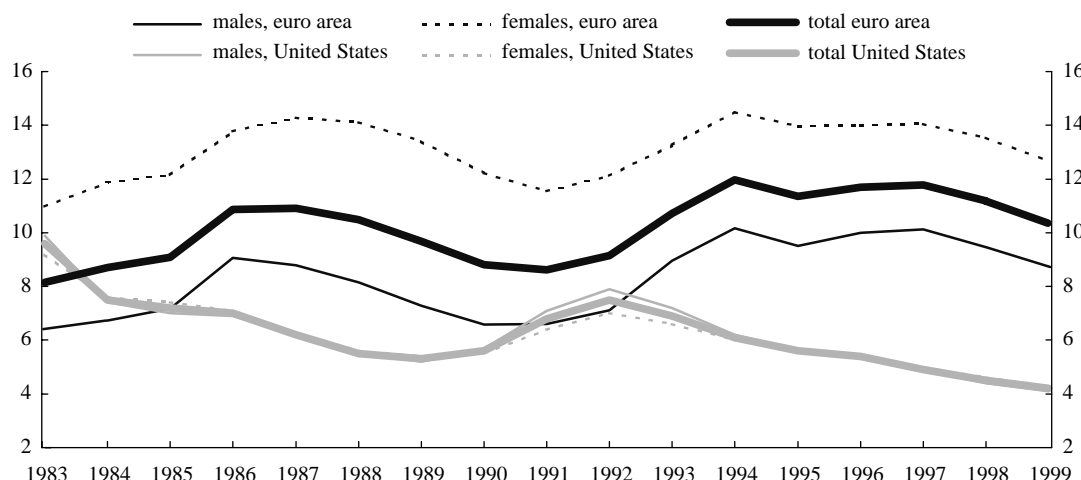
The unemployment rate for females has consistently exceeded that for males (see Chart 9). Since the early 1980s the female

unemployment rate has been on average 4.9 percentage points above the male unemployment rate. By contrast, in the United States, the female unemployment rate has been on average slightly below that of males over the past three decades and the gap has never exceeded 1 percentage point. The high and persistent gap between male and female unemployment rates in the euro area points to structural impediments to employment growth which are specifically detrimental to women, including a lower level of education, the lack of affordable childcare and the tax and benefits systems. The latter (for instance, through maternity subsidies) may create disincentives for married women

**Chart 9**

#### Unemployment rates by gender in the euro area and in the United States

(as a percentage of labour force)



Sources: Eurostat and the OECD.

Note: Data prior to 1994 are ECB estimates.

to look for work if their husbands work or for young mothers receiving social security benefits. This may lead to a reduction in their human capital and therefore their employability, by keeping them away from the labour market for some time.

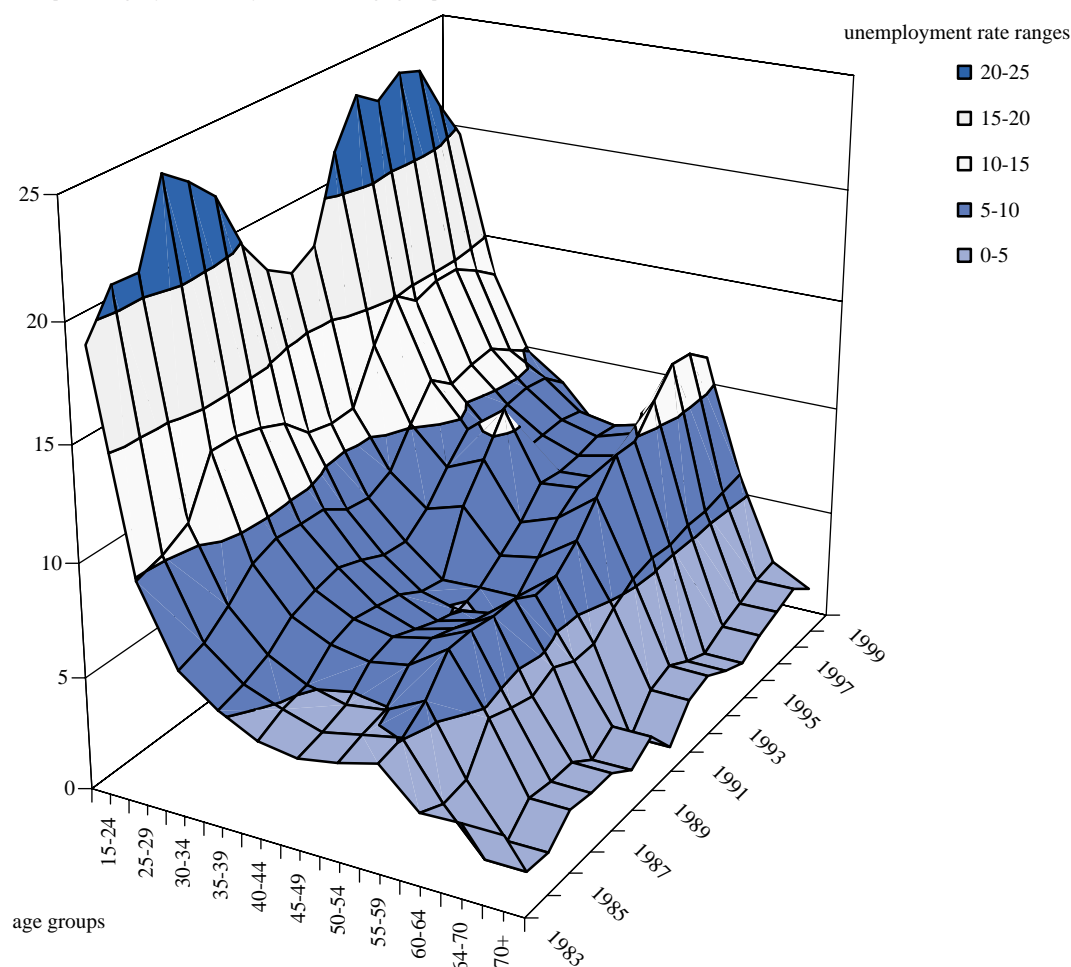
It is worth noting that there is a tendency for countries that have a wide dispersion of unemployment rates among various sub-categories of the labour market – in particular with regard to gender and age groups – to have high overall unemployment rates. Therefore, the breakdown of unemployment into these sub-categories is an important element in the analysis of the euro area labour markets (see Chart 10). Youth unemployment

has tended to be around twice as high as the overall unemployment rate in the euro area. The same is true for the United States but in this case the problems are mostly concentrated among labour force participants under 20, who are more likely to be poorly educated relative to this group in the euro area. In the euro area, the unemployment rate for young people between 20 and 24 years of age is also very high.

Another feature of the euro area labour market, which once again contrasts with the situation in the United States, is the inexorable rise in the unemployment rate of those between 55 and 59. The unemployment rate for this group reached more than 10% at

**Chart 10**  
**Unemployment rates by age group in the euro area**

(as a percentage of the labour force in each age group)



Source: Eurostat.

Note: Data prior to 1994 are ECB estimates.

**Table 2****Unemployment rates by level of educational attainment in the euro area***(as a percentage of the labour force with a corresponding level of education)*

	1995	1996	1997
Tertiary education	6.1	6.2	6.3
Upper secondary education	7.8	8.2	8.5
Lower secondary education or less	11.9	12.1	12.2

*Source: Eurostat.**Note: Data refer to the population aged 25 to 59.*

the end of the 1990s, i.e. twice as high as the level recorded at the beginning of the 1980s. Such a development, mostly due to a rise in male unemployment within this age group, partly stems from large-scale restructuring in some sectors of industry such as the mining sector, which employed an old and mostly male labour force. The skills of older workers in the declining industrial sector have not matched skills required by the expanding sectors.

As already seen in the employment section, labour market developments in the past two decades have not been favourable to low skilled workers. This translates into a higher unemployment rate for this category of people. According to available information,

the lower the educational attainment level, the higher the unemployment rate (see Tables 2 and 3). More than 22% of the unemployed were in the lower skill category (i.e. unemployed persons whose previous occupation was “elementary operator”), while this category represented only 9.3% of total employment. Conversely, the likelihood of becoming unemployed appears to be smaller for highly skilled people.

**Strong regional dispersion**

Unemployment rates are also not evenly distributed at the national and regional levels. It appears that a high national unemployment rate is also associated with a high dispersion

**Table 3****Unemployment and employment by occupation in 1997 in the euro area***(as a percentage of total unemployment or employment)*

	Previous occupation of unemployed	Employment by occupation
Legislators and managers	2.5	6.4
Professionals	4.9	11.9
Technicians	9.7	15.6
Clerks	10.5	13.1
Services and sales workers	15.6	12.8
Agriculture/fishery workers	2.5	4.1
Craft/related trades workers	22.4	16.6
Plant and machine operators	9.6	8.8
Elementary operators	22.2	9.3
Armed forces	0.2	0.6
No response	-	0.9
Total unemployment or employment	100.0	100.0

*Source: Eurostat.*

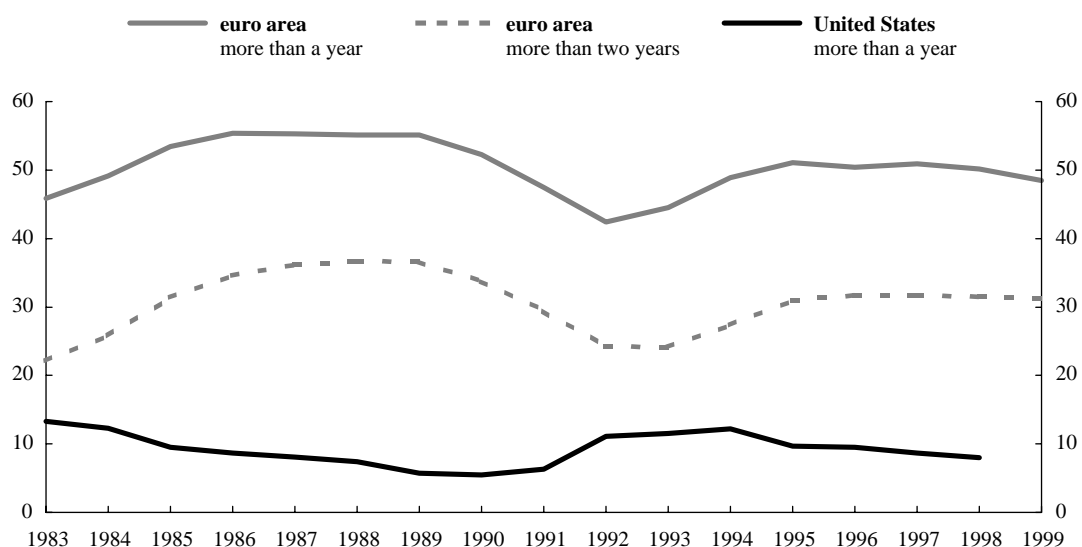
of regional unemployment rates. In 1998 the gap between regional unemployment rates exceeded 20 percentage points in Italy and Spain, 18 in Germany, and reached 15.7 in France, although in the latter country the standard deviation in the unemployment rates was significantly lower than in the three others. High and persistent unemployment gaps between regions may be a sign that the wage formation process is too rigid and does not allow for wages to reflect the local labour market and productivity conditions. As regards the unemployment gap between countries, it partly reflects a low level of cross-country labour mobility within the euro area.

### High unemployment duration

Finally, another important feature of euro area labour markets is the large share of long-term unemployment. In this respect, the situation in the euro area can be sharply contrasted with that in the United States (see

Chart 11). In 1998 only 8% of the United States' unemployed were looking for a job for more than a year, while 42.2% were unemployed for less than a month. At the same time, in the euro area the proportion unemployed for more than a year was more than half of total unemployment and the proportion unemployed for more than two years was nearly one-third of total unemployment. Long-term unemployment is a general problem of the euro area labour markets as its incidence is high in all Member States, including those where overall unemployment is low. A possible explanation of this feature is that structural features in the euro area labour markets increased the persistence of rises in unemployment, which resulted from adverse economic shocks. In other words, people who became unemployed in a period of recession remained unemployed thereafter for structural reasons, including generous unemployment benefits, which could have lowered their willingness to find a new job quickly.

**Chart 11**  
**Duration of unemployment in the euro area and in the United States**  
*(as a percentage of unemployment)*



Sources: Eurostat and the OECD.  
 Note: Data prior to 1994 are ECB estimates.

## 5 Structural factors affecting the labour market

The preceding analysis has identified a number of deep-seated problems in euro area labour markets affecting employment, labour force participation and unemployment. The key findings of this analysis are:

- There has been a trend decline in the employment rate and a rise in the unemployment rate in the euro area over the past 40 years. By contrast, in the United States the employment rate has risen and the unemployment rate has remained broadly stable.
- There is a relative underdevelopment of the services sector in the euro area, while this sector has instead been the source of much of the recent employment growth in the United States.
- In the euro area, labour market problems appear to be concentrated among certain groups in society, such as women, younger and older workers and the low skilled. This is revealed by the lower employment rates and higher unemployment and non-participation rates for these groups. The labour market position for skilled prime-age men appears to be broadly comparable between the euro area and the United States.
- There is a significant regional dimension to unemployment within some euro area countries.
- There is a serious problem of long-term unemployment in the euro area. Rates of short-term unemployment are, however, broadly comparable with those recorded in the United States.

These features have been linked, for example in the OECD Jobs Strategy, to a number of structural factors relating to work incentives, labour costs, mismatch, government regulations and long-term exclusion from the labour market, which are considered in more detail below. However, it is often argued that

negative macroeconomic shocks, interacting with labour market institutions, may also have contributed to the rise in European unemployment. Overly rigid institutional settings may have prevented the necessary adjustment to changes in the economic environment, thus leading to higher unemployment persistence.

### Inadequate work incentives

There are a range of factors affecting the labour market which can serve to reduce the incentive to work. Lower take-home pay owing to high rates of taxation or social security contributions can make work less attractive. The same is true of generous, or open-ended, unemployment or other social security benefits, which may reduce the incentive for the unemployed or the inactive to search for work. Early retirement provisions may also reduce the incentives for older people to continue to work. However, there can be other factors, such as a lack of affordable childcare, which reduce the attractiveness of work. All of these may limit incentives to work and thereby lower employment, leading to higher unemployment and non-participation.

### Excessive labour costs

If pay is too high, firms may reduce their demand for labour, and employment will consequently be lower. Labour costs may be increased not only by higher wages but also by non-wage labour costs such as payroll taxes and social security contributions. Within the euro area the harmful effects of high labour costs may be concentrated among certain groups in the labour market or within certain regions. High labour costs are likely to be a particular problem for those whose productivity may be below average, particularly the young and the low skilled. Excessive wage levels, as well as a low wage dispersion, may be a symptom of bargaining

arrangements that give too much power to those currently employed at the expense of the unemployed and do not allow for enough regional flexibility. The effect of a minimum wage on the employment of younger workers and the low skilled may also be particularly significant if these workers have lower productivity levels.

### **Mismatch**

High unemployment may be due to mismatches in the economy, which can occur at a number of levels. Despite the existence of job vacancies, workers may not have the appropriate skills and may hence remain unemployed. As discussed, the unemployed in the euro area tend to have below average skills and therefore may be unsuitable for the vacancies available for more skilled workers. Furthermore, as indicated by the regional concentration of unemployment, there may be a geographical mismatch if there are obstacles to people moving between areas of high and low unemployment. This applies to potential job moves between and within euro area countries. A wide range of obstacles, such as language and cultural barriers and the lack of transferability of pension rights, may discourage moves between countries. Within countries there can be obstacles created by housing markets, particularly a lack of affordable rented accommodation. In addition, an inadequate transport infrastructure may discourage commuting even relatively short distances to find work.

### **Government regulations**

Government regulations in a number of areas can have an impact on the labour market and have unintended adverse consequences. In many areas, such as health and safety, it is widely

accepted that it is appropriate for government to intervene, even if this reduces flexibility or increases labour costs. However, in other areas – such as employment protection regulations – the role of government intervention is more controversial. While there is little empirical support for the notion that such regulations lead to higher structural unemployment, there is more support for the view that such regulations may raise the average duration of unemployment, reduce labour force participation and slow the adjustment of employment to changing economic circumstances. As the preceding analysis has shown, many of these problems currently seem to afflict the euro area. However, government measures not directly related to the labour market may also affect its functioning, such as government regulations which make it more difficult to set up new businesses or, more generally, the existence of “red tape” that discourages entrepreneurship. There are also restrictions affecting some areas of the product market, such as strict limitations on shop opening hours, which may have served to slow the development of the services sector in the euro area.

### **Long-term exclusion from the labour market**

The very high levels of long-term unemployment in the euro area mean that there are large numbers of people who cannot be easily reintegrated into the labour market. A long period of time spent without work is likely to erode people’s human capital and may make firms reluctant to hire them. Over time it may also discourage them from actively seeking work and lead to their effective withdrawal from the labour market, even though they may still be classified as “unemployed”.



## Box 2

### European labour market initiatives

In the past three years there has been a marked increase in initiatives at the Community level aimed at addressing the issue of the high level of unemployment and the low rate of employment in Europe, as reflected in the conclusions of recent European Council meetings. The major steps which have been taken are summarised in this box.

At the Luxembourg European Council meeting (12 to 13 December 1997) on the co-ordination of economic policy in Economic and Monetary Union, it was agreed to set up a co-ordinated employment strategy within the framework of the Broad Economic Policy Guidelines, the Employment Guidelines and the National Action Plans. While the National Action Plans, which are prepared by the Member States, determine specific areas of action for each country, the Employment Guidelines define general principles for improving labour market performance. These principles cover four areas for action: (1) improving employability in particular for young people and the long-term unemployed; (2) developing entrepreneurship, by making it easier to start up and run businesses; (3) encouraging adaptability of businesses and their employees, notably through more flexible working arrangements; and (4) strengthening equal opportunity policies for women and men, which should permit a higher participation rate for women.

Acknowledging that positive employment effects can be expected from better functioning markets and the further development of new technologies, the Cardiff European Council (15 to 16 June 1998) launched a process aimed at initiating reforms to improve competitiveness and the functioning of the markets for goods, services and capital. The Cardiff process also provides an important opportunity to ensure that structural reforms are as conducive as possible to employment.

At its Vienna meeting (11 to 12 December 1998) the European Council decided that a policy for more employment encompassing macroeconomic policy directed towards growth and stability and the implementation of structural reforms needed to be enhanced by a broad strategy. The European Employment Pact, adopted at the Cologne Summit (3 to 4 June 1999) complements the two pillars stemming from the Luxembourg and the Cardiff processes with a third, which is a regular macroeconomic dialogue at the EU level involving all the economic actors, i.e. the governments, the European Commission, the European Central Bank and the social partners.

Finally, the extraordinary European Council meeting in Lisbon (23 to 24 March 2000) defined an open method of co-ordination with regard to facing the new challenges resulting from globalisation and the emergence of a new knowledge-based economy. It consists in regular meetings aimed at monitoring and assessing progress made within the framework of the Cardiff and Luxembourg processes.

## 6 Concluding remarks

The deep-seated problems of the euro area labour markets summarised above are predominantly structural in nature. A wide range of policy measures exist for dealing with these problems. Clearly, such issues are a matter for national governments and the social partners, and the structural reforms needed will depend on the specific nature of the problem in each country. Nevertheless, over the past few years, the EU has redoubled

its efforts to promote structural reforms aimed at improving the functioning of labour markets (see Box 2). In this regard, the process which started at the EU Council meeting in Luxembourg in 1997 aims to co-ordinate and improve Member States' policies in the field of employment and labour market reforms. As part of this process, Member States adopt annual Employment Guidelines which are implemented by National Action Plans.

The progress made so far in addressing these issues through implementing structural reforms has been patchy, with some countries adopting a wide range of measures while others have been rather less ambitious. Further steps have been taken to improve the functioning of product markets, while less progress has been made in the sphere of labour market reform. Within the euro area most countries are currently pursuing active labour market measures to bring the unemployed (particularly the long-term, the low skilled and the young) back into the labour market. There have also been some reforms of tax and benefit systems aimed at improving work incentives and reducing

labour costs for firms, although these have been rather limited thus far. In some countries that are encountering labour shortages there have been measures to stimulate labour force participation. In other countries there have been measures to reform the regulation of fixed-term or short-term contracts and part-time work.

Although a further fall in unemployment is likely by virtue of the ongoing cyclical upswing, a significant and sustained reduction in euro area unemployment will require further substantial structural improvements in the functioning of the labour market.