

European Unemployment

Prof. Lutz Hendricks

Econ520

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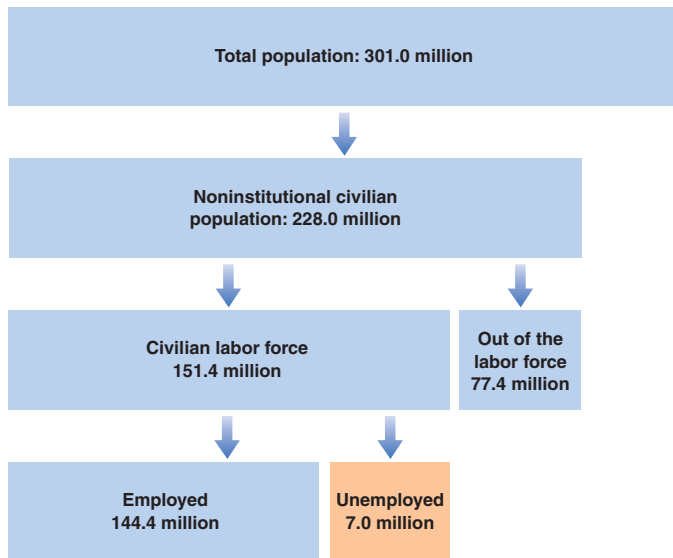
Objectives

In this section you will learn:

1. how European unemployment differs from US unemployment
2. how European labor market institutions contribute to high unemployment rates

Labor Market Facts

Concepts and definitions



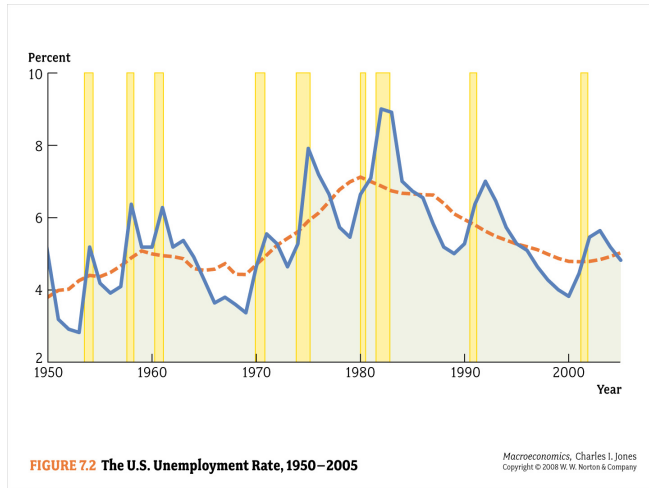
2010 numbers

Unemployment Rate

- ▶ Unemployment rate = $[\text{unemployment}] / [\text{labor force}]$
- ▶ A tricky concept: how to distinguish between
 - ▶ unemployed: looking for work
 - ▶ not in labor force: not looking for work

Unemployment rate: USA

The U.S. unemployment rate has been roughly flat since 1948.



Unemployment rate: Europe

Why did unemployment rise dramatically in Europe?

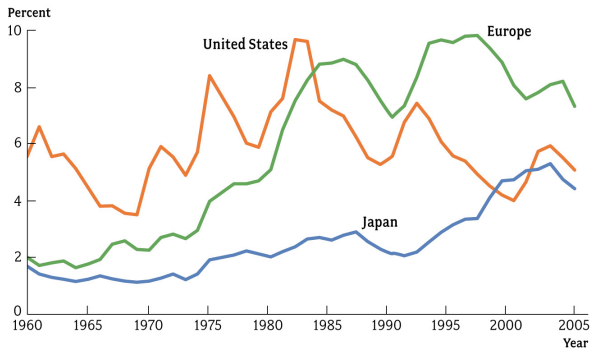


FIGURE 7.7 Unemployment in the United States, Europe, and Japan, 1960–2005

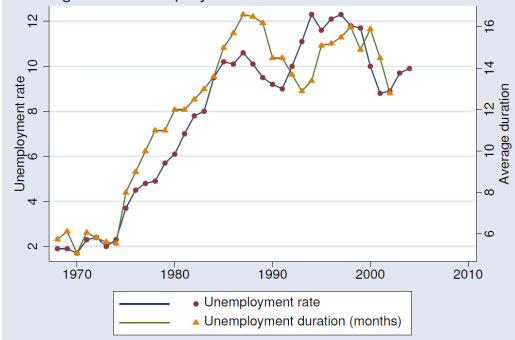
Macroeconomics, Charles I. Jones
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Unemployment Duration

- ▶ Most U.S. unemployment spells are short
 - ▶ about 3 months on average
- ▶ Most of the time spent unemployed is accounted for by a small fraction of long-term unemployed.
 - ▶ about 20% are unemployed longer than 6 months

Unemployment: Europe

Figure 4. Unemployment rate and duration in France



Unemployment in Europe has

- higher level
- longer duration

Source: Blanchard (2005)

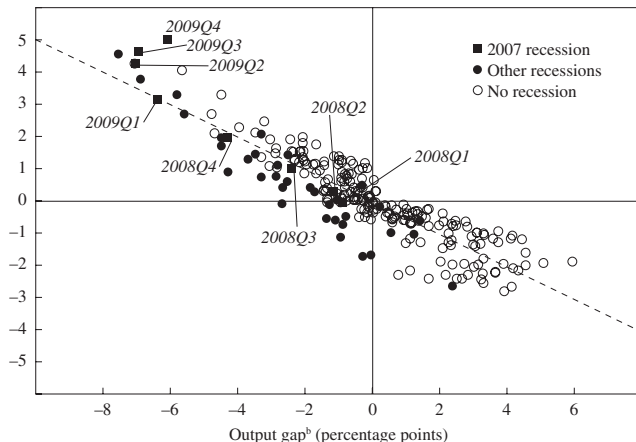
The Puzzle

- ▶ Europe had lower unemployment than the U.S. in the 1950s/60s
- ▶ Since the 1970s, European unemployment has been persistently high
- ▶ Large numbers of long-term unemployed
- ▶ Institutions did not fundamentally change during this period

U.S.: Okun's Law

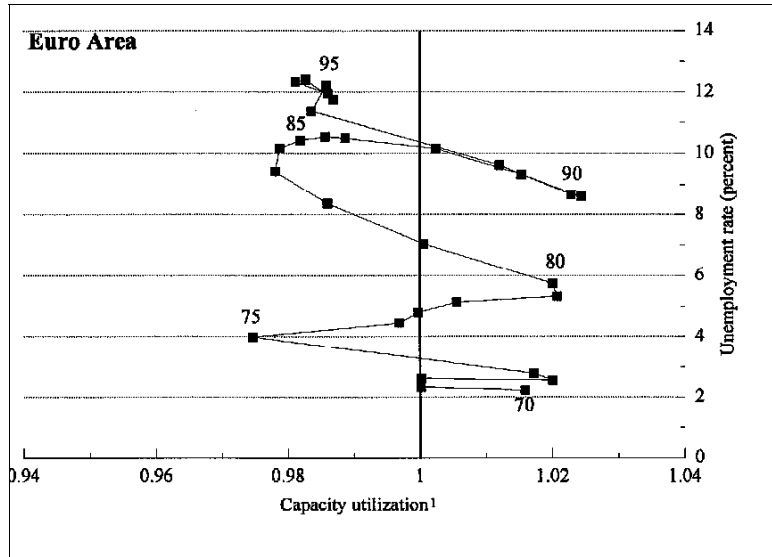
Figure 3. Okun's Law, 1949–2009

Unemployment gap^a (percentage points)



A 1% increase in output (above trend) is associated with a 0.5% drop in unemployment.

Europe: Okun's Law Breaks Down



AS / AD Interpretation

AS/AD Interpretation

- ▶ **U.S.:** Wages are flexible.
 - ▶ In recessions, wages fall and employment need not fall too much.
- ▶ **Europe:** Wages are downward rigid.
 - ▶ Perhaps due to collective bargaining / unions.
 - ▶ In expansions: Wages rise.
 - ▶ In recessions, wages stay flat.
 - ▶ Each expansion starts with lower employment.

AS/AD Interpretation

- ▶ Recall:

- ▶ wage setting: $W/P^e = F(u, z)$
- ▶ AS: $P = P^e(1 + m)F(u, z)$
- ▶ AD: $Y = Y(M/P, G, T)$

- ▶ The typical business cycle with flexible wages

- ▶ AD fluctuates
- ▶ economy moves along stable AS curve
- ▶ real wages fluctuate around trend

Europe

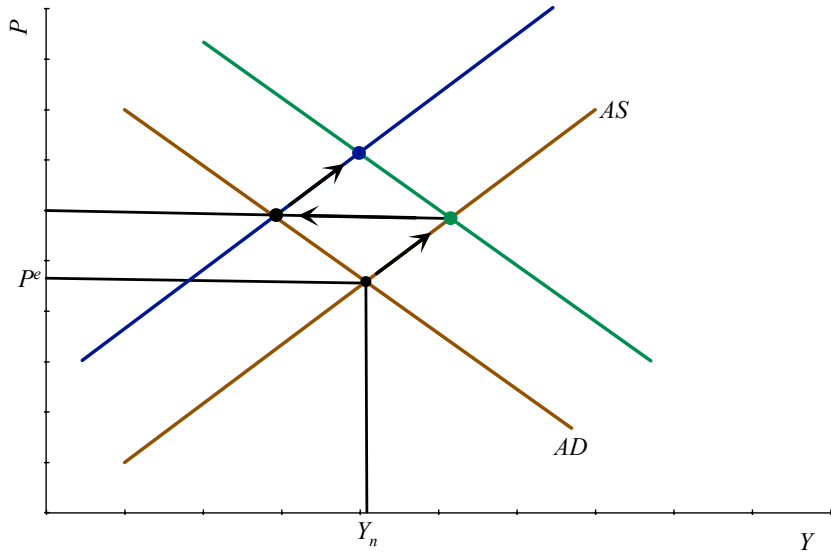
- ▶ During expansion:

- ▶ $Y \uparrow \implies u \downarrow \implies F(u, z) \uparrow \implies W/P^e \uparrow$
- ▶ move along AS curve

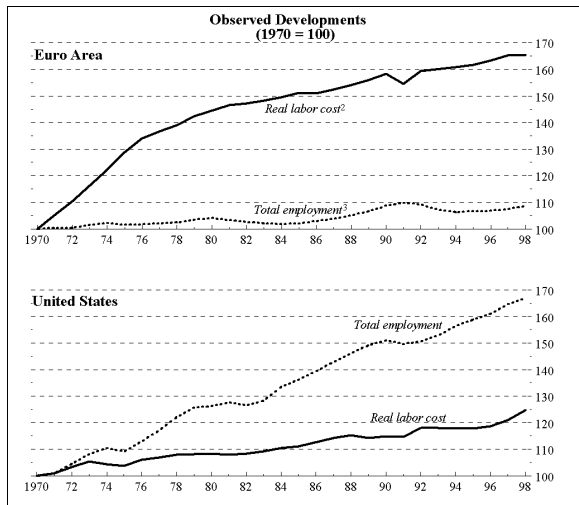
- ▶ During contraction:

- ▶ $Y \downarrow$. Workers stabilize real wages: W/P^e unchanged
- ▶ $z \uparrow$
- ▶ AS curve shifts up $\implies Y_n \downarrow$

Europe



Unemployment and labor cost



Labor costs are consistent with this view.

Institutions

- ▶ European labor markets are more regulated than U.S. labor markets.
- ▶ More generous unemployment benefits.
- ▶ Better protection against layoffs.
- ▶ How does this affect European unemployment?

Employment Protection

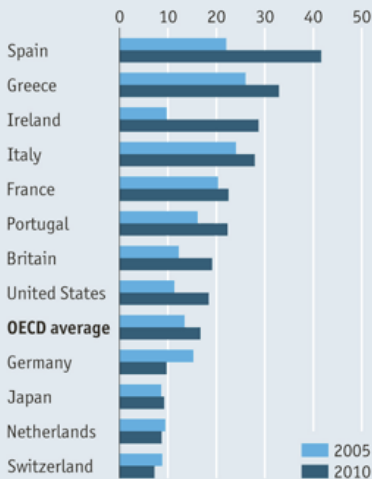
- ▶ How do firing costs affect unemployment?
- ▶ Two effects:
 - 1.
 - 2.

Youth Unemployment in Europe

A poor present

1

Youth* unemployment, selected countries
% of youth labour force



Source: OECD

*15- to 24-year-olds

Source: Economist.com

Countries with rigid employment protection have high youth unemployment.

The Puzzle

- ▶ In 1960 European labor markets were already highly regulated with generous worker protections
- ▶ But unemployment was still low

Increasing Turbulence

1950s:

- ▶ strong growth
- ▶ high “stability”

Since 1970s: Turbulence

- ▶ oil shocks
- ▶ financial liberalization
- ▶ trade liberalization
- ▶ move to floating (volatile) exchange rates

Implications of Turbulence

- ▶ Labor earnings are more volatile.
- ▶ Workers need to “retool” more often.
- ▶ Job changes lead to larger wage losses (obsolete human capital).
- ▶ The result: employment protection becomes more distortionary.

Implications of Turbulence

Low turbulence:

- ▶ Displaced workers can find jobs with comparable pay.
- ▶ They search for jobs, even if unemployment benefits are generous.

High turbulence:

- ▶ Displaced workers take a pay cut.
- ▶ A larger fraction prefers unemployment over work.

Reading

- ▶ Blanchard / Johnson, Macroeconomics, 6th ed., ch. 8
- ▶ Ljungqvist, Lars (2003). "European Unemployment: Labour Market Institutions and Economic Turbulence." DICE 1(2): 7-12.
http://www.cesifo-group.de/portal/page/portal/ifoHome/b-publ/b2journal/40publdice/_publdice2003?item_link=dicereportindex03.htm
- ▶ Ljungqvist, Lars (2010). "Unemployment Crisis - Challenge and Opportunity." CESifo. http://www.cesifo-group.de/portal/page/portal/DocBase_Content/ZS/ZS-CESifo_Forum/zs-for-2010/zs-for-2010-1/forum1-10-focus2.pdf
- ▶ The Economist: The Jobless Young. Sep 10th 2011.
<http://www.economist.com/node/21528614>

Advanced Reading

- ▶ Jones, *Macroeconomics*, ch. 7.
- ▶ Elsby, Michael W. L.; Bart Hobijn; Aysegül Sahin (2010). “The Labor Market in the Great Recession.” *Brookings Papers on Economic Activity*, Spring, pp. 1-48. DOI: 10.1353/eca.2010.0001