Euro area labour markets respond to crisis

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In February 2015 the ECB published a research paper 'Comparison and contrasts of the impact of the crisis on euro area labour markets'[1] elaborated by an ad hoc team of the European System of Central Banks as part of the ECB Occasional Paper Series. Národná banka Slovenska actively participated in this process and contributed to its content. The article summarizes the general findings of the research paper and presents some interesting details about the Slovak labour market in the euro area context.

General Trends

Paper elaborates on two phases of the recession with respect to developments on the labour market of the euro area, the Great Recession 2Q2008 – 2Q2009, and second phase 4Q2011 – 1Q2013.[2] A notable feature throughout the crisis has been the considerable degree of cross-country heterogeneity of labour market adjustments across the euro area – with some economies emerging relatively unscathed, while others have seen steep and persisting increases in unemployment.

Effects of the two phases were somehow different. First phase brought more general and wide spread difficulties to all euro area economies, although of the different degree. On the other hand, second phase was focused and affected group of economies with precedent substantial macroeconomic imbalances. These economies are referred to as stressed and contain Cyprus, Greece, Ireland, Italy, Portugal, Slovenia and Spain, rest of the economies is referred as other euro area countries.

The euro area unemployment rate reached its long term minimum in the first quarter of 2008. Since then the indicator was deteriorating with only short lived correction (mid 2010 to mid 2011). In the second quarter of 2013 unemployment rate reached its peak of 12%, gaining almost 5 percentage points in the meantime. 5 percentage points translates into 5.5 million heads without job.

Consequences of the two recessions for euro area labour market differ in time and nature across economies. Some suffered only for a short period of time while others were unable to recover for a longer time. Also demographical and sectoral impact showed to be uneven. In the first phase construction, manufacturing and transport sectors experienced highest job destruction, particularly in each euro area economy. On the other hand, second phase hit stressed economies relatively more than other and also different sectors. Necessary austerity measures in stressed countries translated into high employment losses in public sector. With respect to demographical characteristics – the young, the unskilled and on temporary contracts were those who suffered highest employment losses. Youth and long-term unemployment have risen substantially.

Slovak Labour Market in the Recession

Unemployment reaction to the crisis in Slovakia was quite exceptional compared to euro area 18 economies. Slovak unemployment was highest at the beginning of the crisis but change in unemployment was one of the lowest during the crisis. In the first quarter of 2008 Slovak unemployment reached 10.5% ranking 18. In the second quarter of 2014 it increased by 2.7 percentage points to 13.2%. That counts for fifth lowest increase (not counting decrease of unemployment rate for Malta -0.1pp and Germany -3.3 pp[3]). Relatively slow increase of unemployment resulted in four other countries reporting absolutely higher unemployment rate than Slovakia (ranking 14) in the middle of 2014 – Portugal, Cyprus, Spain and Greece.

Unemployment increases were higher during the first phase. This trend is also different from euro area average. In the group of other economies only two more (Estonia and Latvia) lost more jobs in the first phase than in the second.

Dynamic aspect of the labour market shows similar results. Flows between employment and unemployment provide additional information. Movement out of employment (measured as job exit rate probabilities[4]) was one of the lowest for the Slovak labour market among covered economies. Some 1% job exit rate probability recorded in pre-crisis period increased to 1.5% in the first phase and to 1.6% in the second phase. Pre-crisis EA average amounted to 4.3% rising in the first phase to 4.7%.

Taking closer look at employment development provides further details about labour market dynamics during the recessions in Slovakia. Breakdowns by gender, age, education and contract type were inspected. Percentage changes in employment 1Q-4Q2013 to 1Q-4Q2008 are presented in the next paragraph.

More male than female employees lost their jobs in Slovak economy. This was prevailing trend

1 *Ad hoc team of the European System of Central Banks. Comparison and contrasts of the impact of the crisis on euro area labour markets. ECB Occasional Paper Series, No. 159, Feb. 2015. For further acknowledgements please refer to the box in this article.*
2 *For relevance and comprehensiveness reasons certain analyses do not strictly follow given time intervals but cover shifted periods.*
3 *In Germany, declines are likely to reflect improvements to labour market flexibility as a consequence of comprehensive reforms (Hartz I-IV) introduced in advance of the crisis and the longer-term features of German labour market institutions.*
4 *The average size of these flows over the pre-crisis period (2005Q1-2008Q1) is compared with the subsequent two phases of the crisis.*

in most of the euro area economies. Age group 25-54 lost highest percentage of jobs followed by age group 15-24. Surprisingly, age group 55-64 was only one with job gains. This wasn't exception in euro area as EA average and 13 out of 18 economies recorded the same trend[5]. Permanent employees lost jobs but self-employed and temporary gained jobs. Finally, low level and medium level educated cohort lost jobs but medium level educated loss dominated. This contrasted with EA average. On average far higher percentage of low level educated saw employment losses and only minor employment losses contributed medium level educated. High level educated gained employment in Slovak economy.

Special attention is paid to youth unemployment. Group of young workers was heavily affected over the course of the crises. Greece, Spain, Italy, Cyprus, Portugal and Slovakia belong to group of economies in which youth (15-24) unemployment rate exceeded 30% mark in 2013 (in percent of the youth labour force). Ireland, France, Belgium, Latvia, Slovenia and Finland fall into the 20-30% interval. 10-20% interval contains Estonia, Luxemburg, Malta and the Netherlands. Only Austria and Germany reported youth unemployment below 10%.

The very rapid response of youth employment to the crisis can be partly explained by their high representation among temporary workers, who are more vulnerable to cyclicality than permanent workers. Interestingly, youth employment continued to decline despite the short lived period of economic upturn starting from mid-2009 (during which employers' uncertainty about the potential future recovery could have pushed hires with temporary contracts up). Moreover, common to many euro area labour markets is the growing trend of long-term unemployment among the young unemployed rising from around 8.0 pp of the youth unemployment rate in advance of the crisis in 2007, to 12.9 pp in 2013. In other words, around 54% of unemployed youths in 2013 had been looking for a job for more than one year.

Policy recommendations

Based on the findings of the paper, several policy issues deserve attention. In the presence of high unemployment, a flexible response of wages to labour market conditions is essential to facilitate the necessary sectoral reallocation and to encourage job creation. A greater emphasis on reducing labour market segmentation is required to improve firms' flexibility to respond to changing demand conditions and to provide increased access to work and training for those disproportionately hit by the crisis. A stronger effort should be put on re-prioritizing active labour market policies, to prevent hysteresis effects and reduce the risk of persistent unemployment turning into structural unemployment. Further reforms to collective bargaining as well as to tax and benefit systems are necessary so that firm-level agreements can better reflect local labour market conditions and to increase the economic incentives to work. Reducing employment protection legislation for some groups would speed up the reallocation of labour resources to more productive sectors. Overall, reforms which deliver greater flexibility in employment and wages will reduce adjustment costs associated with idiosyncratic shocks and enhance the efficiency and effectiveness of the monetary policy transmission mechanism. Finally, labour market reforms must be accompanied by increased competition and reforms on product markets, for the euro area to respond optimally and rapidly to economic shocks.

5 *This trend must be treated carefully as other factors may contribute to job gains for the age group 55-64, namely trend of population aging.*

Paper builds on Structural Issues Report on "Euro area labour markets and the crisis" published in October 2012. Ten out of the euro area 18 (2014) national central banks participated together with representative of Denmarks Nationalbank and fellow from the University of Amsterdam. Team was chaired by Robert Anderton, coordinated and paper edited by Valerie Jarvis and Béla Szörfi and supported by Mathilde Périnet and Pavlos Petroulas all from ECB. Marek Micuch and Alexander Karsay represented NBS.

Paper uses quarterly LFS micro data. Participating banks gathered and processed individual datasets for their own economy. Besides introduction and conclusions paper contains three major sections: (ii) Labour market dynamics and unemployment over the crisis; (iii) Evidence of structural labour market changes over the course of the crisis and (iv) The adjustment of wages during the crisis.

Abridged version of the paper was published in the October 2014 ECB Monthly Bulletin. Some of the underlying charts together with some labour market reform recommendations for euro area economies were outlined in President Draghi's speech at the 2014 Economic Policy Symposium at Jackson Hole, entitled "Unemployment in the euro area".

References

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4. ECB. Monthly Bulletin. The Impact of the Economic Crisis on Euro Area Labour Market. October 2014.