Europe

A risk of job-less recovery

The euro area emerged from recession during the second quarter of 2013 after 18 months of contraction, the longest in its history. A firming in output and business expectations is visible, especially in Germany. At the same time, improvements in external competitiveness in severely crisis-hit countries have put the recovery on a broader basis, allowing both domestic and external factors to contribute. However, these improvements have not been strong enough to make a significant dent on unemployment, which remains very high.

The lacklustre nature of the economic recovery is caused, in part, by the continued pursuit of fiscal consolidation policies in the region. In contrast to the positive if weak impulses to growth from the private sector, governments in several economies continue to reduce their primary deficit by raising taxes and/or lowering spending. Even some of the countries that have sufficient fiscal space to provide a stimulus to aggregate demand, that could potentially spill over to the region as a whole, pursue fiscal consolidation. This complicates the achievement of both employment and fiscal targets. Indeed, in the context of weak economic growth, public revenues remain depressed and public spending difficult to contain.[1]

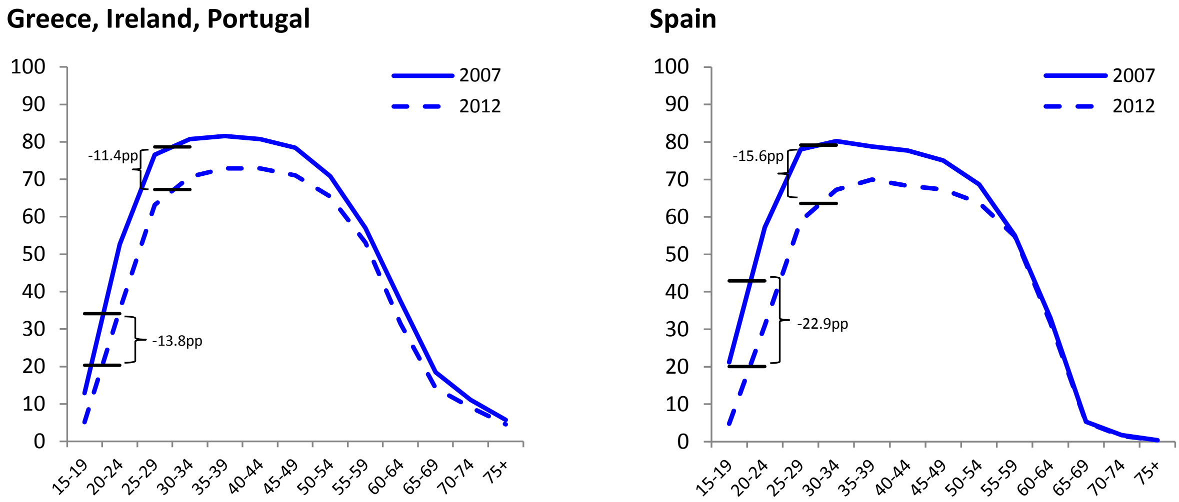
Further risks remain. Despite continuous easing of monetary policy in the euro area, long-term rates have started to increase and firms, especially in crisis countries, continue to be shut off from taking out credit.

Large employment gap for young adults

In addition to still high total and youth unemployment rates in many countries, a particularly worrisome trend is the large employment gap for young adults (aged 25-34). In certain countries, employment losses have been more pronounced for this age group than for youth. Indeed, young adults are the first to face job losses in crisis times due to their lower seniority and the job protection afforded to older workers. At the same time, they often cannot benefit from specific youth labour market programmes or retraining to improve their labour market chances, making a return to employment for this age group particularly protracted.

[1] See International Monetary Fund (IMF). 2013. *World Economic Outlook (October). Transitions and tensions*, (Washington, DC).

Figure 1. Job losses by age group – selected economies
(employment-to-population ratio by age group in per cent, 2012 vs. 2007)



Note: pp = percentage points. The graph displays employment-to-population ratios by 5-year age brackets for a selection of countries in 2007 (solid line) and 2012 (dashed line). The black dashes indicate the evolution of the employment-to-population ratio for youth (15-24 years) and young adults (25-34 years) between 2007 and 2012.

Source: ILO Global Employment Trends and OECD online database.

Overall, it was younger age groups that suffered most from the crisis (see figure 1). For instance, employment in Greece, Ireland and Portugal as a whole declined by 1.6 million between 2007 and 2012, but 75 per cent of this reduction, i.e. 1.2 million jobs, was concentrated among younger people (aged 15-34 years). In Italy, young adults faced a sharper decline in their employment-to-population ratio than youth, whereas older workers (aged 55-64) actually benefited from an increase in employment between 2007 and 2012. Clearly, this concentration of job losses among younger workers bodes ill for a more rapid recovery if policy-makers are not taking decisive steps to expand their efforts to include young adults as well.

Some fiscal stimulus measures targeted at bringing down unemployment rates were introduced in the European Union during 2013, where policy-makers adopted the plan to implement youth guarantee schemes in the countries hit hardest by the crisis and released funds to combat youth unemployment. At the time of preparing this report, these decisions have not had any measurable impact, given that so far no funds have been spent. Such measures, however, are likely to provide some much-needed stimulus to the crisis economies. ILO simulations show that employment-friendly policies are indeed likely to lead to improvements in the labour market, without harming fiscal sustainability in the medium term.

Long-term unemployment is on the rise

Labour market mismatch has increased since the peak of the crisis in many countries. As sectoral demand for labour has shifted, unemployed workers find it more and more difficult to find employment opportunities in their previous sector of activity. In crisis countries that had benefited from large increases in housing investment prior to the crisis (e.g. Spain), the dramatic loss in employment in the construction sector has led to an important shift in skills demand and sectoral movements in employment. But even in countries that seem to have managed to protect their labour market from the effects of the crisis, shifts in external demand have triggered a rise in skills mismatch over recent years (e.g. Germany). Such a shift in the mismatch between skills offered and skills in demand will complicate the labour market recovery, as jobseekers need to acquire the relevant skills before being able to benefit from new employment opportunities. Countries therefore need to provide sufficient means for investment in training and education targeted specifically at those unemployed workers in crisis sectors.

Unemployment is becoming more persistent, although it is now mainly weak hiring rather than job destruction that keeps joblessness rates high. The beginning of the crisis saw a substantial uptick in labour shedding. Job destruction has now stabilised or continues a downward trend in those countries for which data are available. However the continuous rise in average unemployment duration indicates a lack of job creation. Taken together, these trends confirm that the crisis is actually slowing down structural adjustment of the economy towards faster growing sectors, thereby limiting the potential for a quick recovery.

Monetary stimulus has prevented worse outcomes but has limitations and potentially adverse consequences

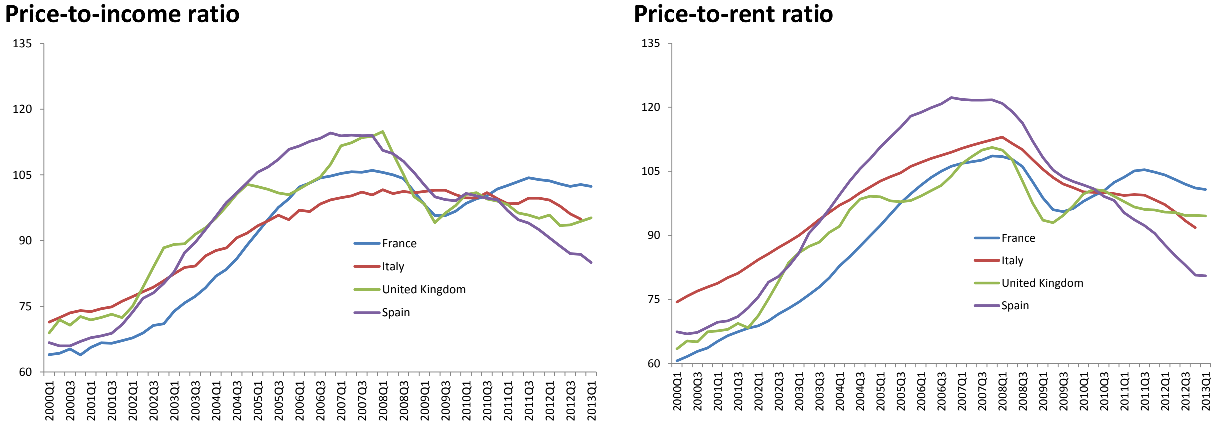
In response to the sharp and abrupt decline in economic activity brought about by the global economic crisis, major central banks in Europe and around the world dramatically reduced short-term lending rates starting in 2008. In addition, unconventional measures to boost economic activity and to counter the risk of deflation have also been enacted by some central banks – most notably, large-scale asset purchase programmes or “quantitative easing”, which aims to lower bond yields and expand the monetary base, thereby encouraging lending and boosting economic activity.

These measures were adopted in the context of lagging wages vis-à-vis productivity gains, resulting in higher corporate profits. The rise in corporate profits and inexpensive borrowing did not, however, spark an investment boom in the real economy. Rather companies have decided to pay ever larger dividends to their shareholders. In addition, firms have been buying back their own shares, and issuing debt to do so, with the aim of further bolstering share prices.

Are house price cycles responsible for the slow jobs recovery?

Many advanced economies continue to experience house prices above historical averages both in comparison to both disposable incomes and rents (see figure 2). In some countries, high house prices can at least partly explain their large and persistent increase in unemployment. House price increases can negatively impact on unemployment through two channels: first, house price inflation may lead to faster wage growth (“competitiveness effect”); second, house price inflation may depress aggregate productivity as the size of the construction sector in the overall economy increases.

Figure 2. House price developments in selected EU countries



Note: Index: 2010 = 100.
Source: ILO Global Employment Trends.

At the same time, positive house price developments have long been welcomed as a positive driver of growth. As increases in house prices and house ownership makes private households feel richer, private consumption is expected to expand faster than economic activity (the "wealth effect"). Also, stronger house price increases allow for faster employment creation, as they will lead to the expansion of the construction sector, an employment-intensive industry. Prior to the crisis, many studies found that the housing cycle had a positive effect on business activity and that housing investment should be supported by government interventions – to the extent that house price increases were considered sustainable. ILO estimates show, however, that house price inflation can indeed lead to improvements in employment and economic activity over the short term but that the competitiveness effect of house prices on the labour market worsens the outlook considerably and is long-lasting. House prices currently remain high, which therefore can explain part of the persistence in unemployment. This needs to be tackled – particularly in crisis countries – for employment to be restored more rapidly.

Emerging challenges

Taking into account the high level of aggregate unemployment and especially the devastating level of youth unemployment, the main challenge for most EU countries is to stimulate job creation and increase the level of employment, with a particular attention to young workers and the long-term unemployed. While mounting imbalances led to the crisis, the policy of fiscal consolidation without addressing the core of these imbalances has not been able to restore sufficiently high economic growth that would contribute to new job creation and a reduction of unemployment. Therefore the delicate policy task is to formulate a balanced growth strategy for Europe that would foster solid and sustainable job-rich growth while meeting fiscal consolidation in the medium term. This requires the restoration of genuine social dialogue between the social partners to discuss appropriate policies to address the negative effects of the crisis.

Along with new job creation, it is similarly important to improve the quality of existing and new jobs while also tackling rising in-work poverty. Advanced Europe is rapidly ageing and the challenges this presents can only be overcome through increased labour productivity, among others by investing in human capital through education and skills development as well as increasing employment levels by (re)-integrating inactive groups of the population and reducing unemployment.