Unemployment in Europe: what does it take to bring it down?

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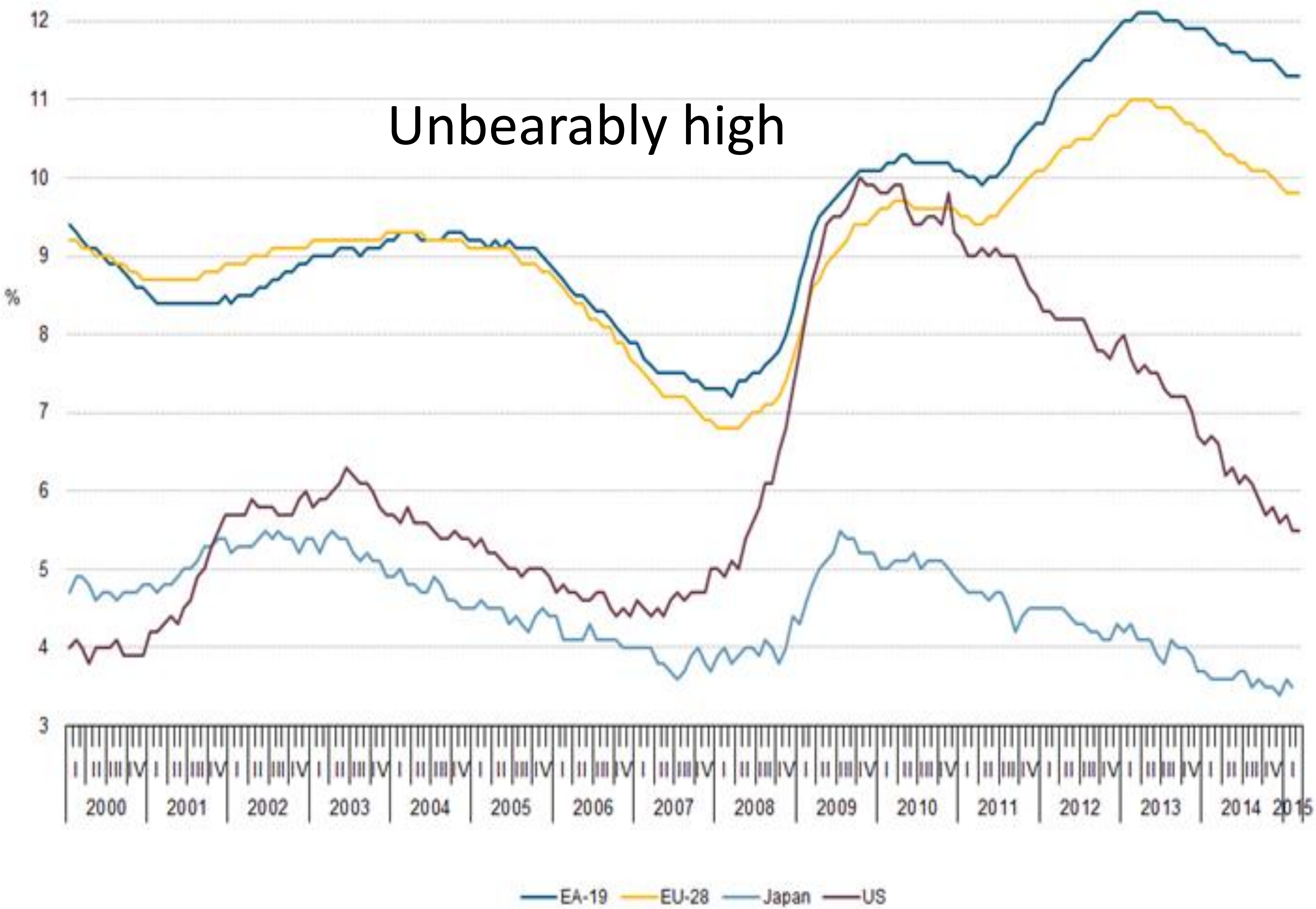
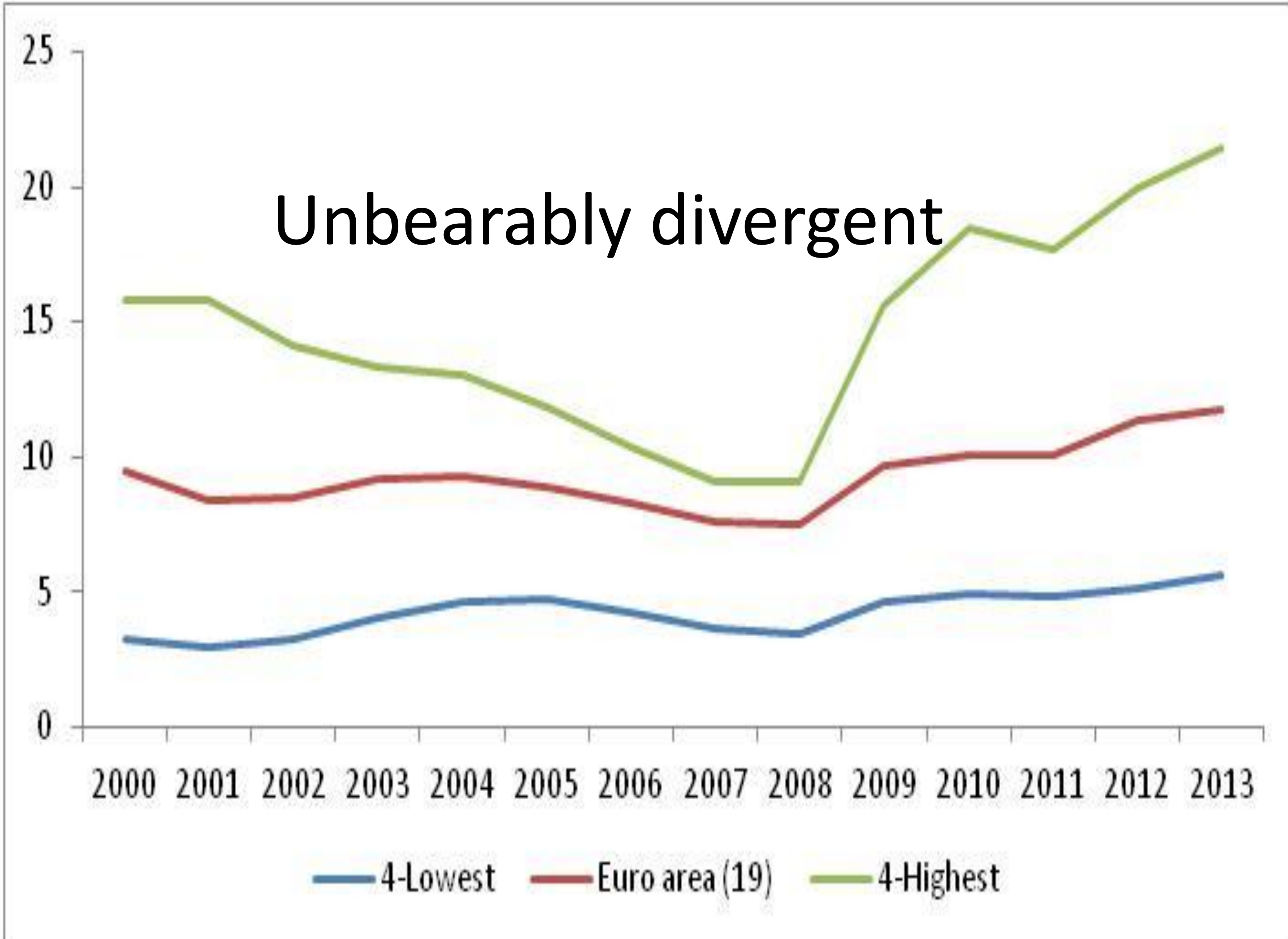
Sintra, May 23 2015

Unbearably high



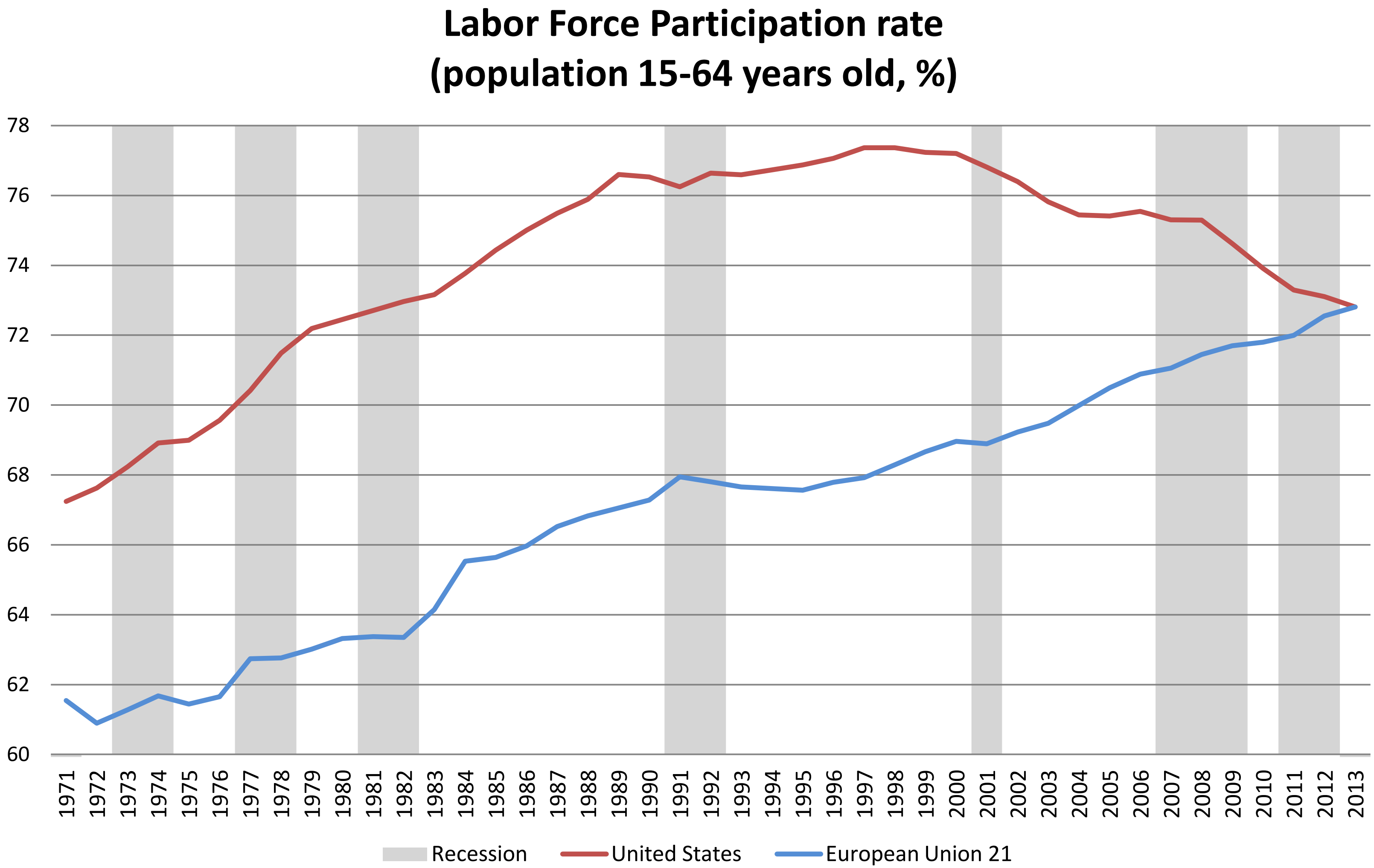
Unbearably divergent



Outline

- Why is Unemployment diverging in the Euro area?
- Interactions between shocks and institutions
- Did policy co-ordination and conditionality at the EU level help to deal with unemployment divergence?
- No
- What can be done *at the EU level* to reduce unemployment divergence?
- Empowering citizens rather than Governments

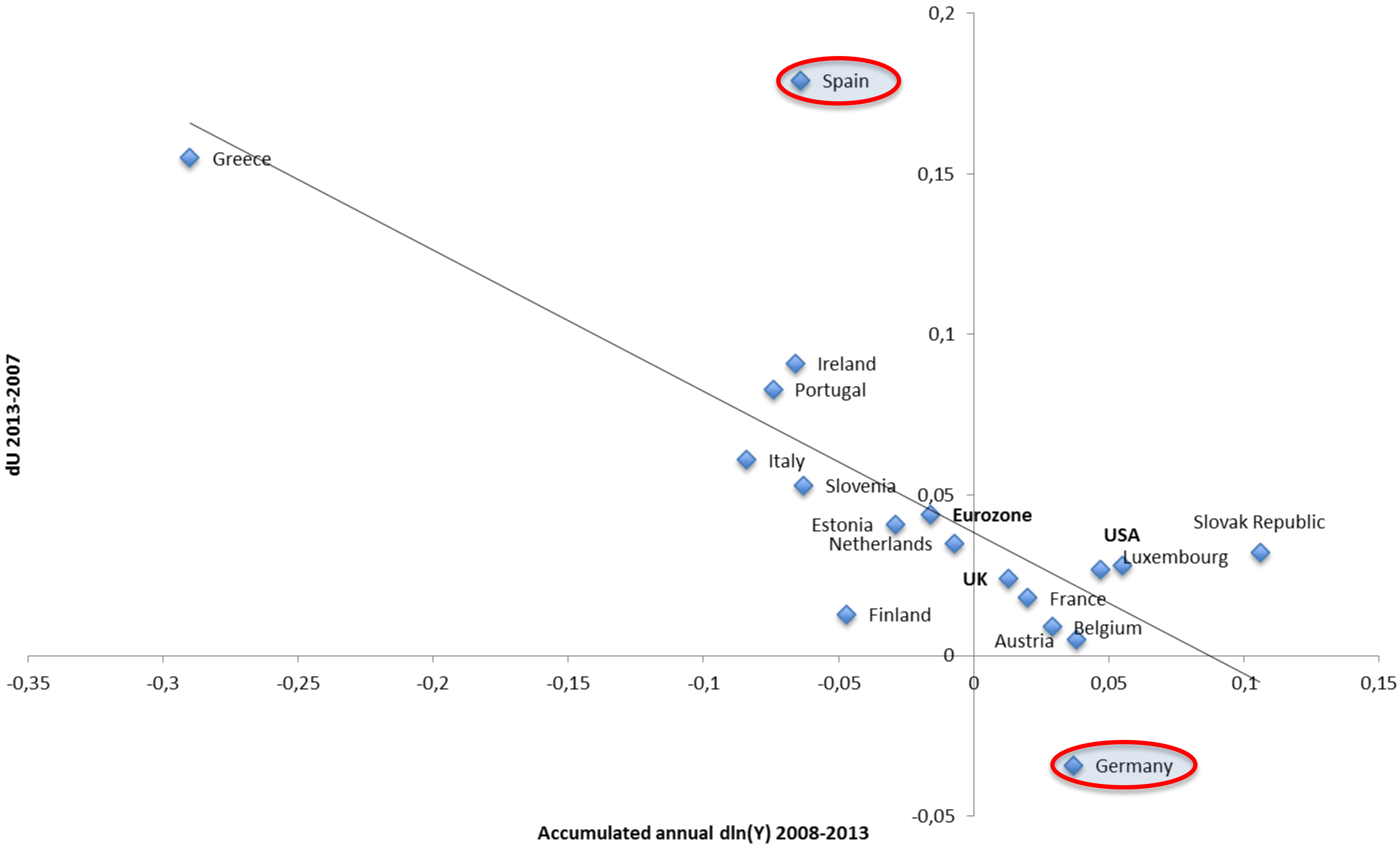
This time was different



Facts pointing to institutions

- Participation is largely driven by institutions (retirement, part-time, family reconciliation)
- Institutions differ *across* rather than *within* countries and heterogeneity is driven by increased difference in national (as opposed to regional) unemployment rates
- Only about 50% of differences in unemployment variation during the crisis can be accounted for by size of the output fall

Okun's law



0,2
0,15
0,1
0,05
0
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-0,3
-0,25
-0,2
-0,15
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0
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Spain
Greece
Ireland
Portugal
Italy
Slovenia
Eurozone
Estonia
Netherlands
USA
Slovak Republic
Luxembourg
UK
France
Finland
Belgium
Austria
Germany
dU 2013-2007
Accumulated annual dln(Y) 2008-2013

Learning from the Outliers

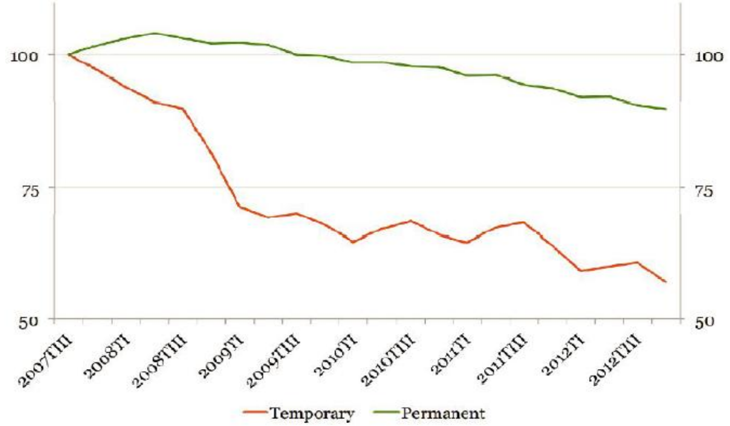
Germany

- Adjustment along hours, wages and non-participation margins
- Short-time work, working accounts and mini(multiple)-jobs operating along intensive margin
- Collective, but decentralized bargaining allowing to trade wage reductions with less layoffs
- No increase in retirement age

Spain

- Adjustment only along one margin: temporary employment

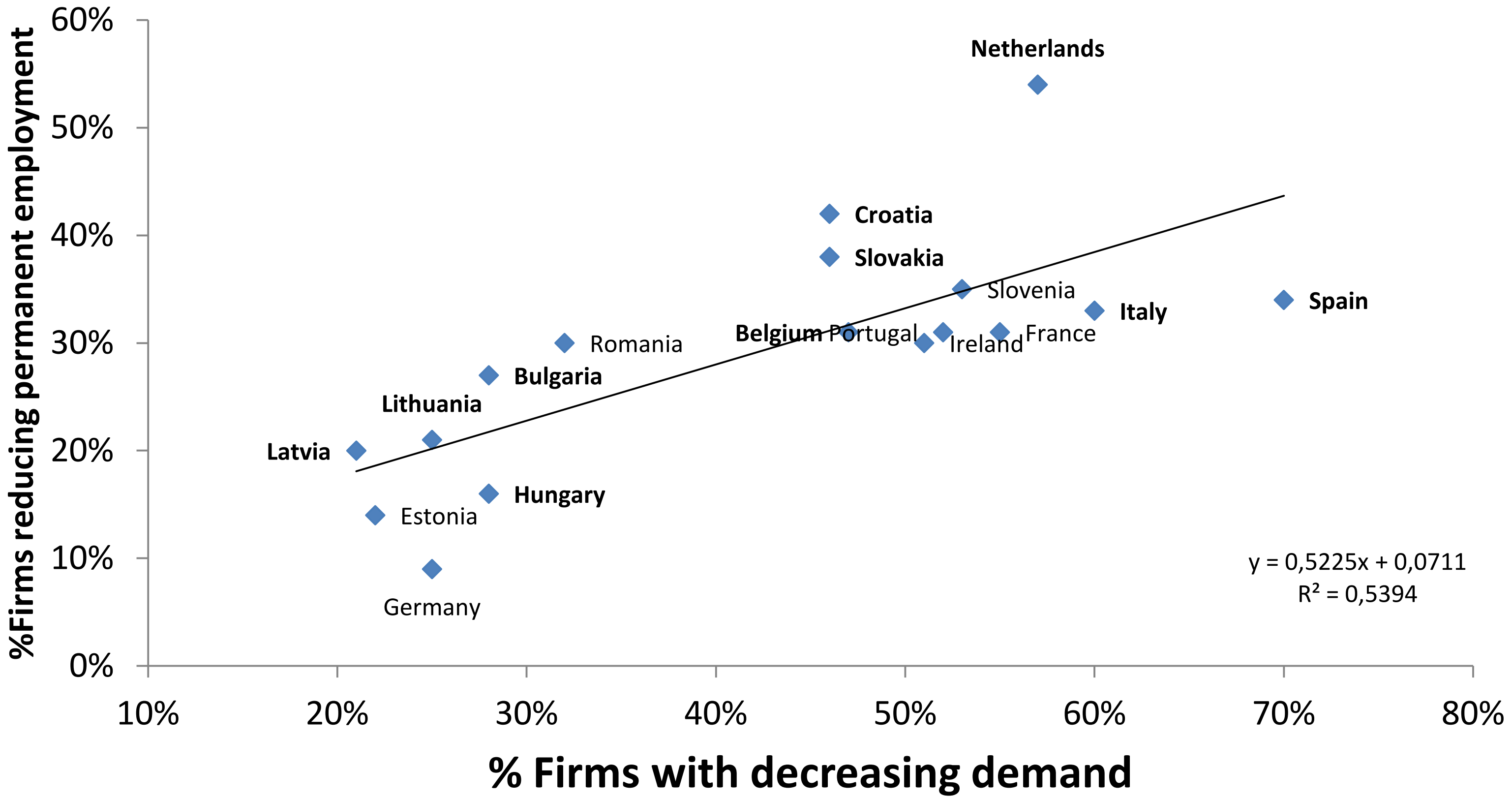
Permanent and temporary private employment (2007Q3=100)



Source: INE, Labor Force Survey.

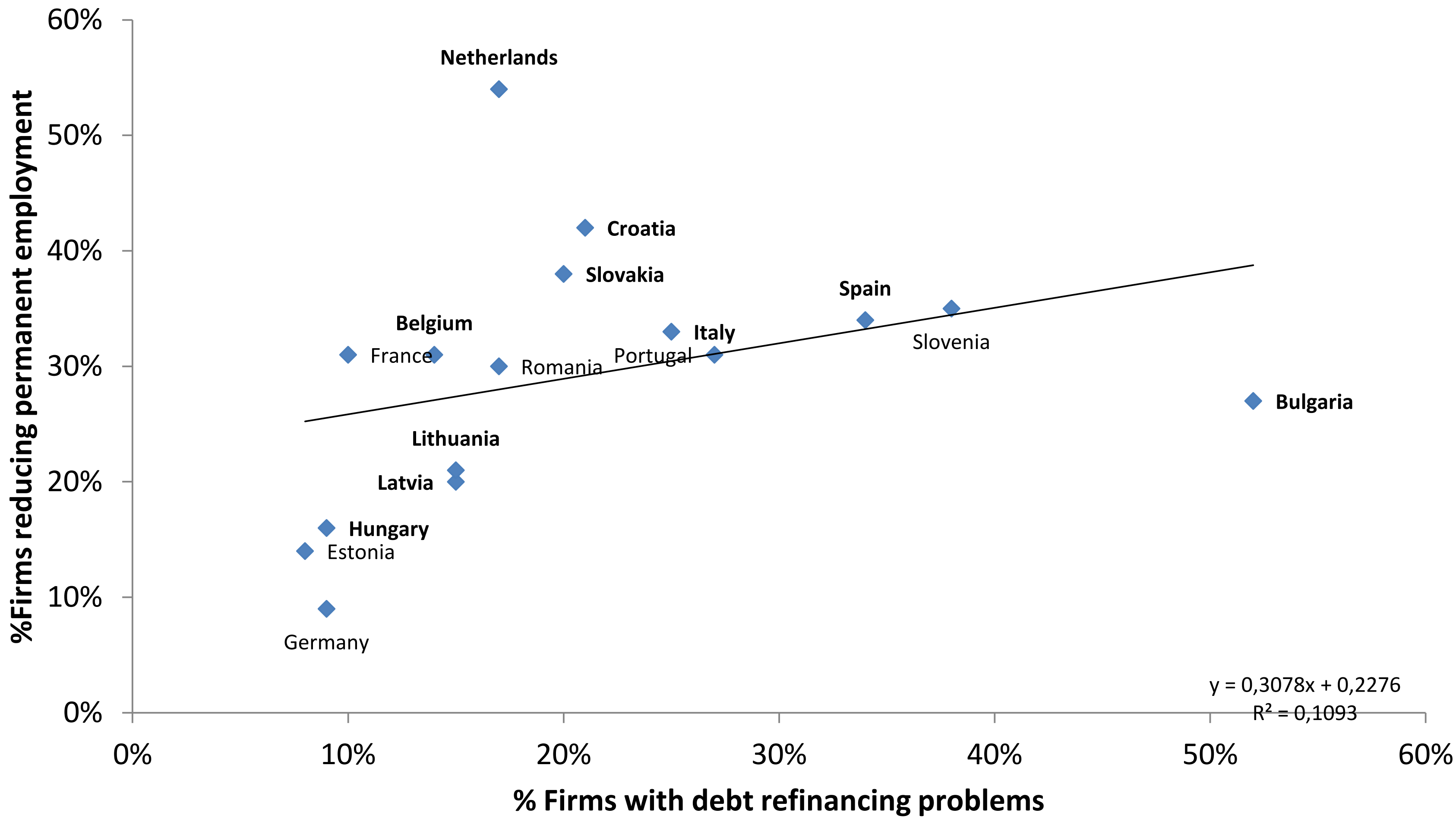
Some micro evidence on the the nature of shocks

- Demand matters

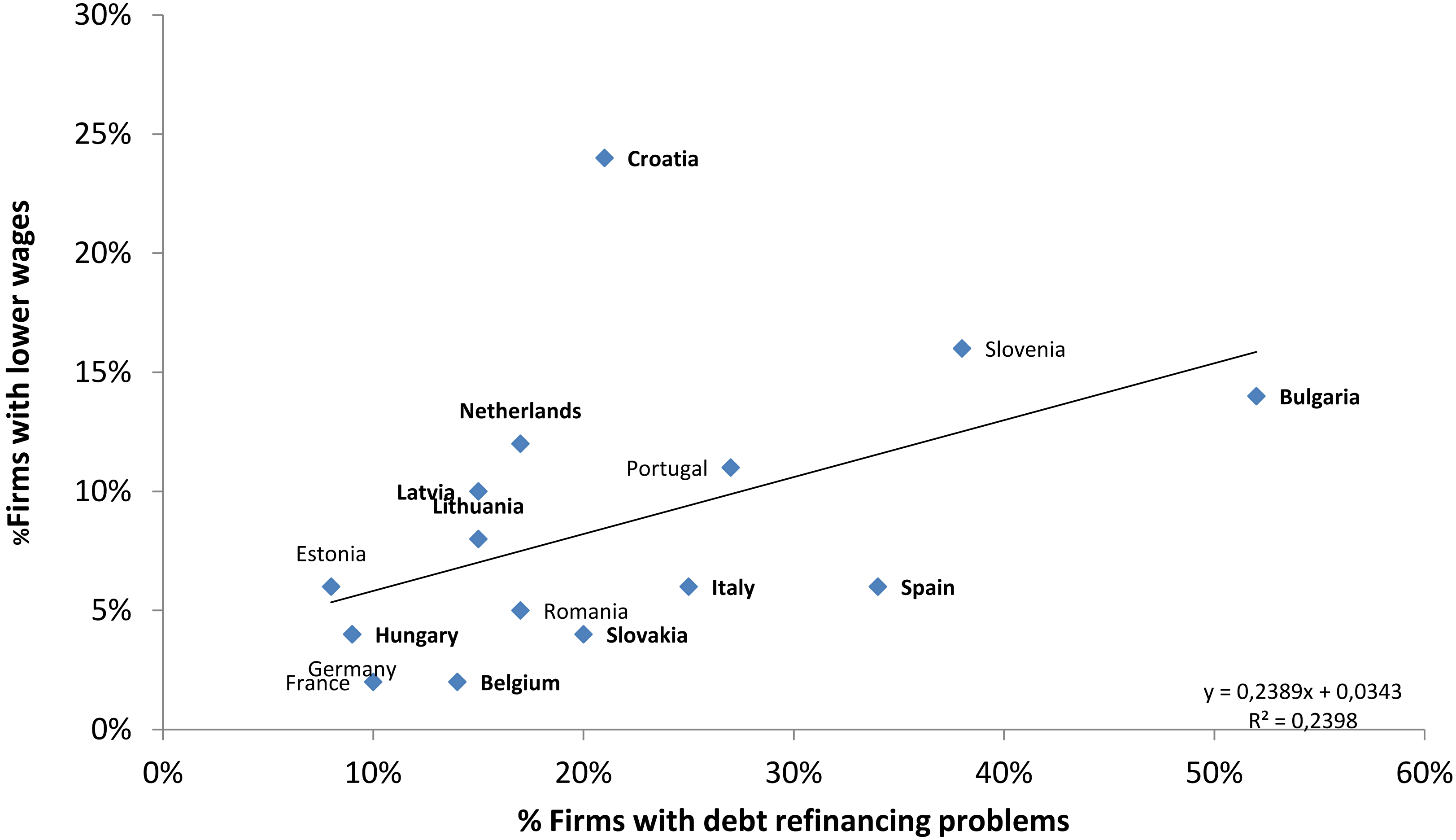


Employment adjustment and credit squeeze

- Finance too



Borrowing from workers?



Summary on facts

- Different labour market institutions imply different labour response to output shocks. Interactions between shocks and institutions are crucial.
- Good to have institutions allowing for adjustment along several margins, not just (temporary) employment
- Need for micro rather than macro wage flexibility. Refinancing problems accommodated with wage reductions (borrowing from workers) but it is demand shock to be behind job destruction

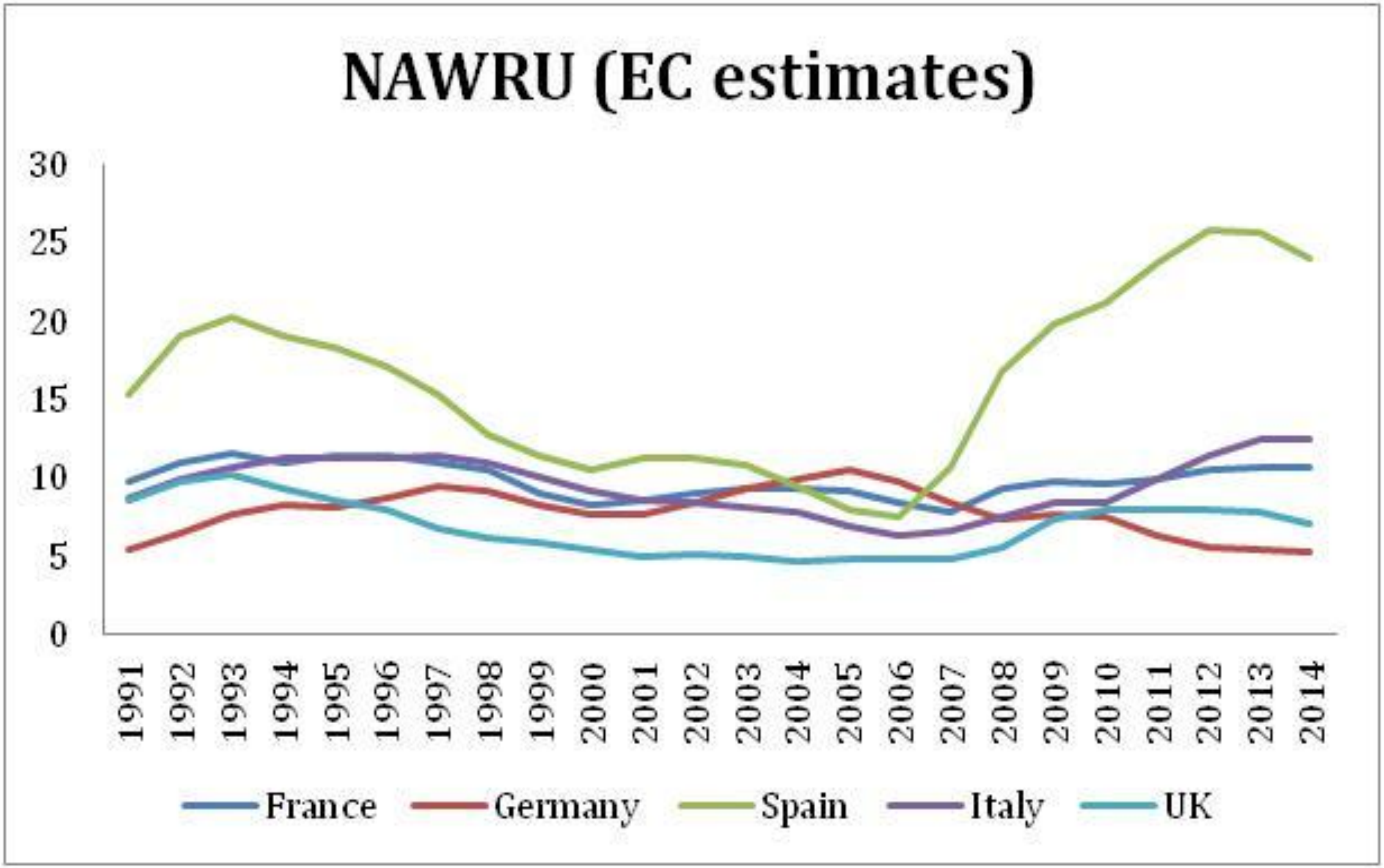
Outline

- Why is Unemployment diverging in the Euro area?
- Did policy co-ordination and conditionality at the EU level help to deal with unemployment divergence?
- What can be done at the EU level to cope with unemployment divergence?

What went wrong in Europe

- **Fiscal policy co-ordination** not allowing for gradual consolidation to countries undergoing a major recession. Automatic stabilizers could not operate
- **EU Conditionality** imposing reforms that may backfire during recessions and missing other important reforms. Limited learning from the «European lab» (best practices)

Is the NAWRU (NAIRU) a useful concept under major recessions?



Bad Conditionality

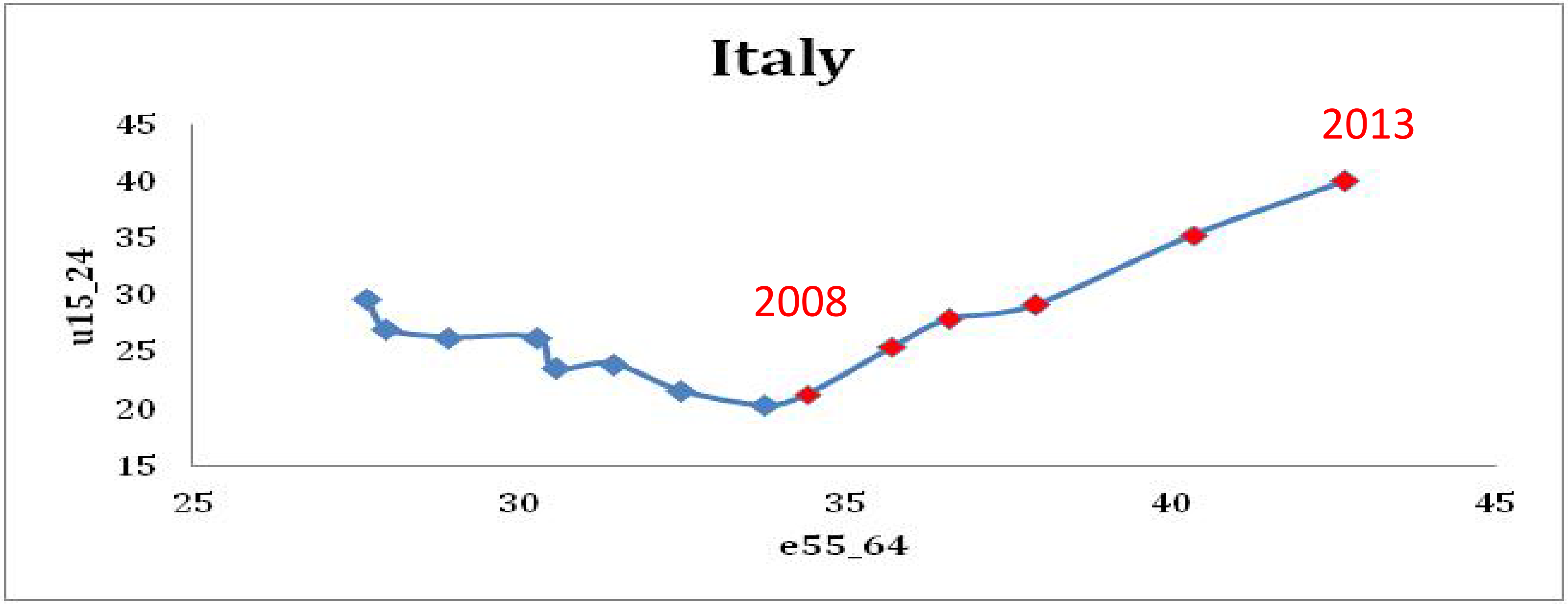
- If not always bad advice, bad implementation
- Reductions in layoff costs during recessions rather than changing contract rules for new hires to address dualism
- Forced declines in the coverage of unemployment, disability pensions and health benefits…
- .. and cuts to minimum wages rather than changes in bargaining structures
- Strong increase in retirement age obtained
- Nothing on short-time work

Example of Troika conditionality in Greece

- Reduction in the duration of unemployment benefits
- 1/3 to 1/4 cuts in minimum wages
- Reduction of the coverage of collective bargaining: no more national level in a country dominated by SMEs
- Cuts to public sector pay (13° and 14° monthly instalments)
- Abolition of housing benefits
- Increase in retirement age
- Lower coverage of health insurance
- Reduction of severance pay

The timing of labor reforms over the cycle

- Case for rule-based countercyclical unemployment benefits
- Reforms of employment protection under recessions increase job losses with limited effects on job creation
- Increasing retirement age during downturns may increase youth unemployment



Outline

- Accounting for the increasing heterogeneity of unemployment in the Euro area: shocks or institutions?
- Was policy co-ordination and conditionality at the EU properly exerted during the Great Recession and the Eurozone crisis?
- What can be done at the EU level to reduce unemployment divergence?

From negative to positive conditionality

- Introducing complementary institutions at the EU level rather than abolishing national ones
- Access conditioned to adopting “best practice” institutions
- Risk-sharing and solidarity principles
- Targeting individuals rather than Govts. EU contribution to individual accounts, such as:
    1. European Equal Opportunity Contract
    2. European Unemployment Insurance Scheme
    3. NDC Pensions as automatic stabilizers

Equal opportunity contract

- New open-ended contract with tenure-related “optimal severance” and individual accounts (Austrian Fund and Italian new open-ended contract)
- European contributions (Structural Fund, European Social Fund) to the individual accounts of workers hired under the new contract
- Employers benefit from change in EPL and lower labor costs
- Workers benefit from more stability
- Both gain from more human capital investment on-the-job

European Unemployment Benefit

- Implement the European unemployment insurance scheme through the individual accounts of the workers hired under the best practice institutions.
- Dolls, Fuest, Neumann and Peichl, (2014): with proper contingent and claw-back mechanisms, it does not need to imply substantial permanent transfers across countries, while preserving some redistributive and stabilization properties.

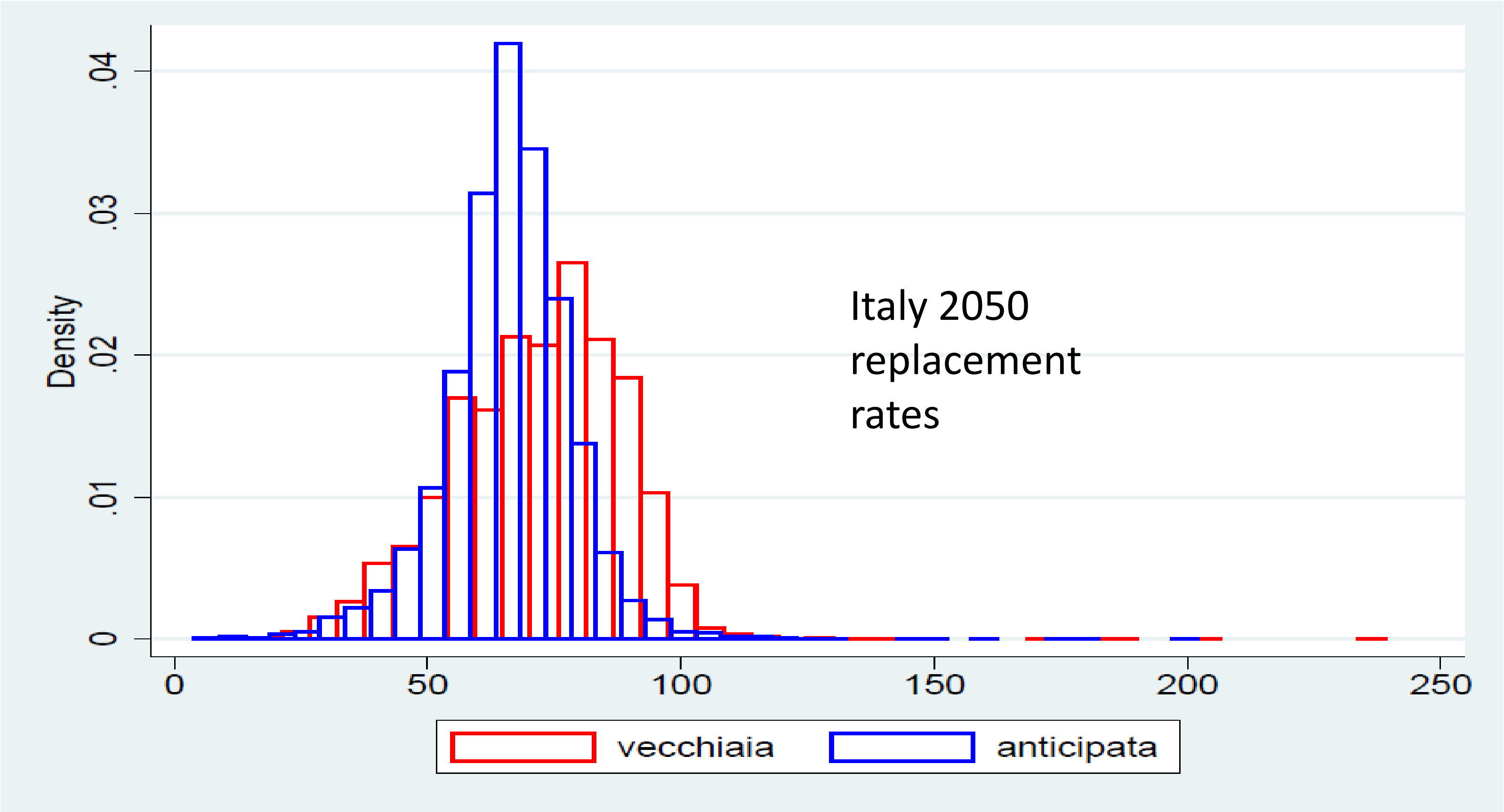
Pensions as stabilizers

- Defined contribution systems allow for some sustainable flexibility in retirement age
- Actuarially neutral reductions for those retiring earlier
- This flexibility can be used during deep recessions to reduce impact on unemployment and allow «cleansing effects» of recessions to operate

Make the pension debt explicit

Checking also social sustainability.

Projections of distributions not only averages



Final Remarks

- There is not a European unemployment problem
- But there is a need for a stronger initiative of supranational European institutions in fighting unemployment
- Put the money where the mouth is. Invest in the new institutions