

The Structure of the Labour Market

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Readings

- Vani K Borooah, “Globalisation, Barriers to Employment and Social Exclusion”, Australasian Journal of Regional Studies, vol. 7, no. 3, 2001
- H.M. Treasury, EMU and Labour Market Flexibility, 2003
<http://news.bbc.co.uk/1/shared/spl/hi/europe/03/euro/pdf/8.pdf>
- Bill Conerly, European Unemployment Lessons for the US
<http://www.ncpa.org/pub/ba/ba475/ba475.pdf>

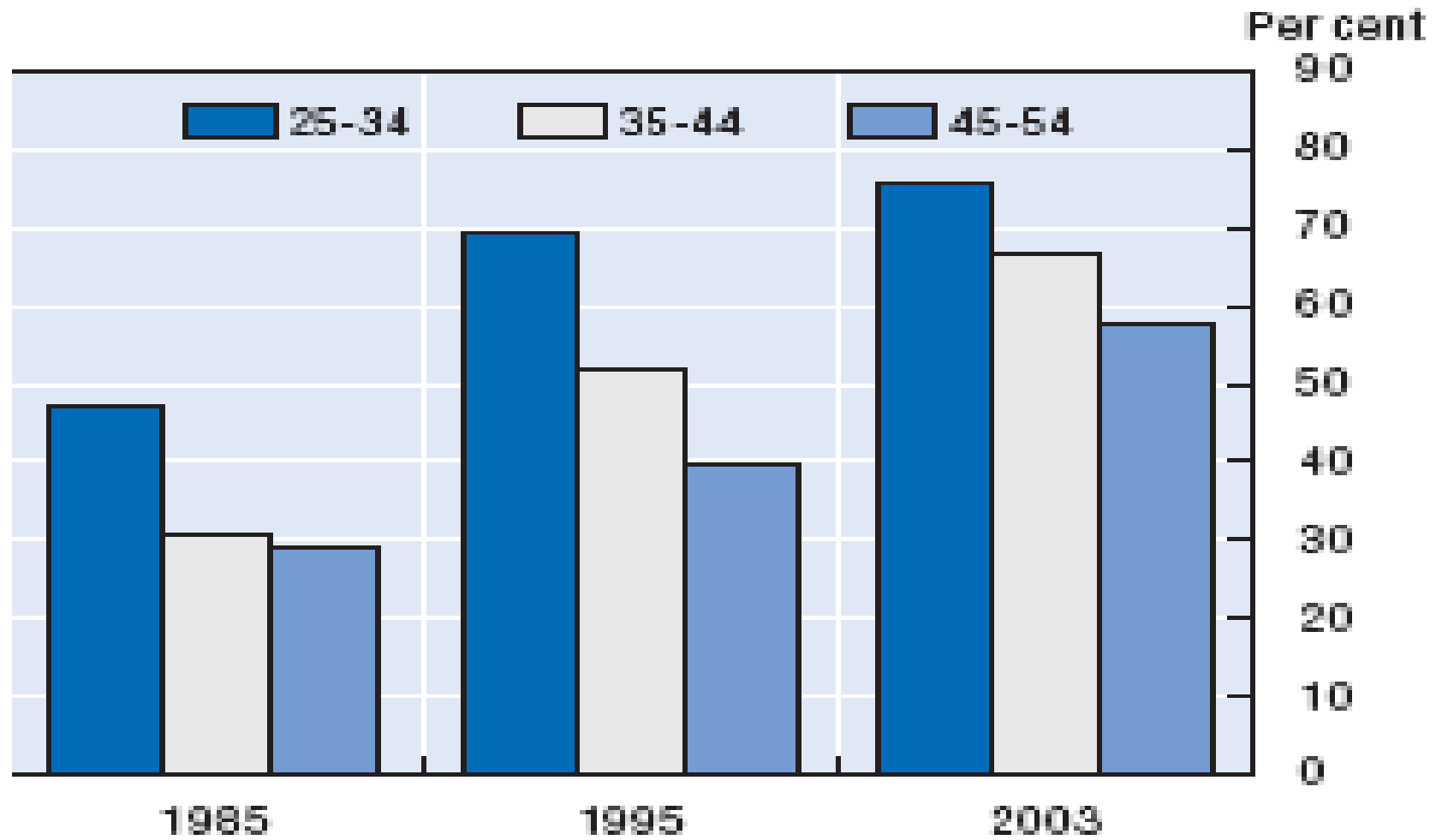
Participation Rate

- The proportion of a country's working age population that wishes to work is its participation rate
- People (currently) wishing to work are said to be “economically active”
- People who do not (currently) wish to work are said to be “economically inactive”

Variations in the Participation Rate

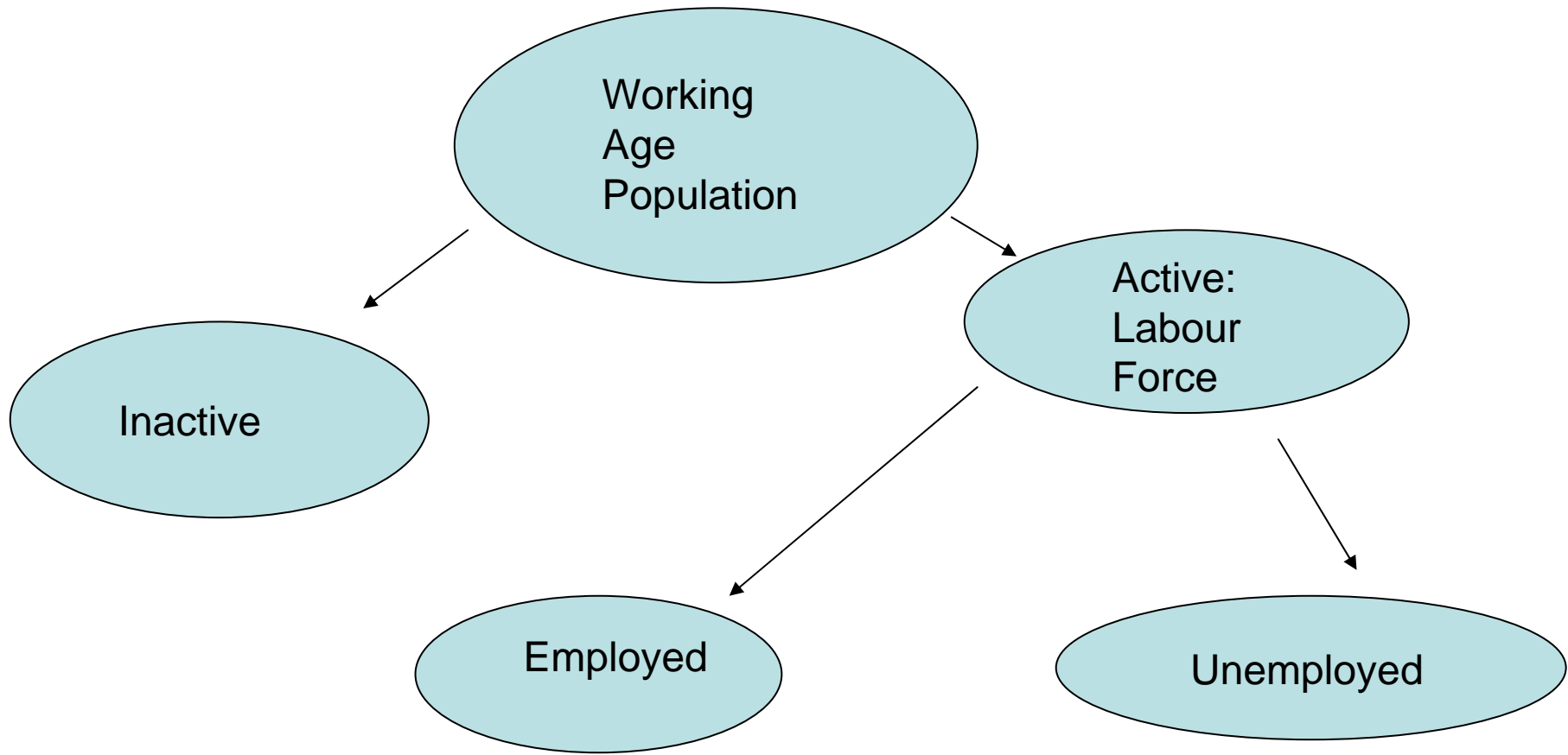
- The participation rate varies by population subgroup
 - Men have a higher participation rate than women
 - Men between ages of 25-45 have a higher participation rate than younger or older men
 - Women with school going children have a higher participation rate than those with pre-school children
 - Better educated persons have a higher participation rate than people with lower levels of education

D. Female labour force participation is rising



The Labour Force

- The Labour Force consists of all those persons who are economically active
- They may be employed or jobless
- The unemployment rate is the proportion of the labour force that is jobless
- The jobless rate is the percentage of a country's working age population that is not employed
- The employment rate is the percentage of a country's working age population that is employed: $100 - \text{jobless rate}$



A Diagrammatic Representation of the Labour Market

Basic Labour Market Identity

$$\frac{Y}{P} = \frac{W}{P} \times \frac{L}{W} \times \frac{E}{L} \times \frac{Y}{E}$$

where:

Y is output

P is population size

W is working age population size

L is labour force size

E is employment size

Or...

Per capita GDP

Y/P

=

=

support ratio \times

$(W/P) \times$

participation rate \times

$(L/W) \times$

1-unemployment rate \times

$(E/L) \times$

productivity

(Y/E)

Policies to raise per capita output

- Raise the worker to pensioner ratio
- Raise the participation rate
- Reduce the unemployment rate
- Increase productivity

Reducing Unemployment: I

When employment rises, some of the new workers come from the unemployed but some come from the inactive

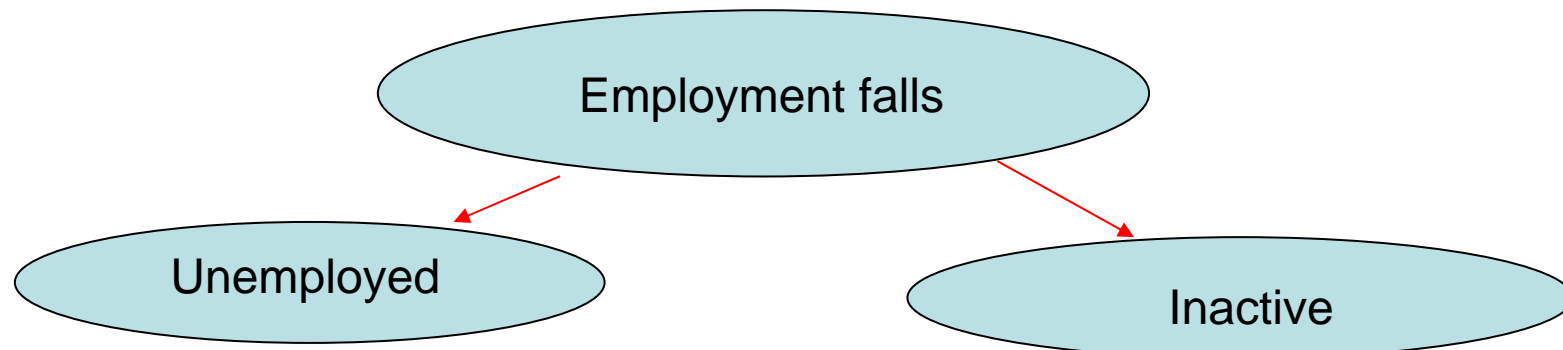
So unemployment falls, but not by as much as the rise in employment



Reducing Unemployment: II

When employment falls, some of the laid off workers join the unemployed but some join the inactive

So unemployment falls, but not by as much as the falls in employment



Reducing unemployment

So, there are two ways of making the unemployment figures look good:

- Create jobs
- Push people into inactivity by:
 - Putting them on government training schemes
 - Reclassifying them as sick or disabled
- In addition, people may become discouraged from seeking work: “discouraged workers”

Measuring Unemployment

The number of people who are unemployed may be measured in either of two ways:

- The claimant count measure is based on the number of persons who have signed on as unemployed
- The International Labour Office (ILO) measure is based on the number of persons who say they are searching for, and ready to start, work

Claimant Count Measure

- The major advantage of the CC measure is that it is easy to produce up-to-date figures for unemployment
- Its disadvantage is that the CC measure may present a true measure of unemployment
 - Claiming benefit is subject to administrative rules and, therefore, to administrative manipulation
 - The CC measure includes claimants who may not be seeking work; it excludes non-claimants who are seeking work

The ILO measure

- The ILO measure corresponds to most people's idea of being unemployed: jobless, seeking and available
- Its disadvantage is that information regarding these qualities can only be ascertained from surveys
- The Labour Force Survey (LFS), which is standardised across countries, obtains this information
- But, this information is presented with a time lag so that LFS unemployment figures are, typically, 6 months out of date

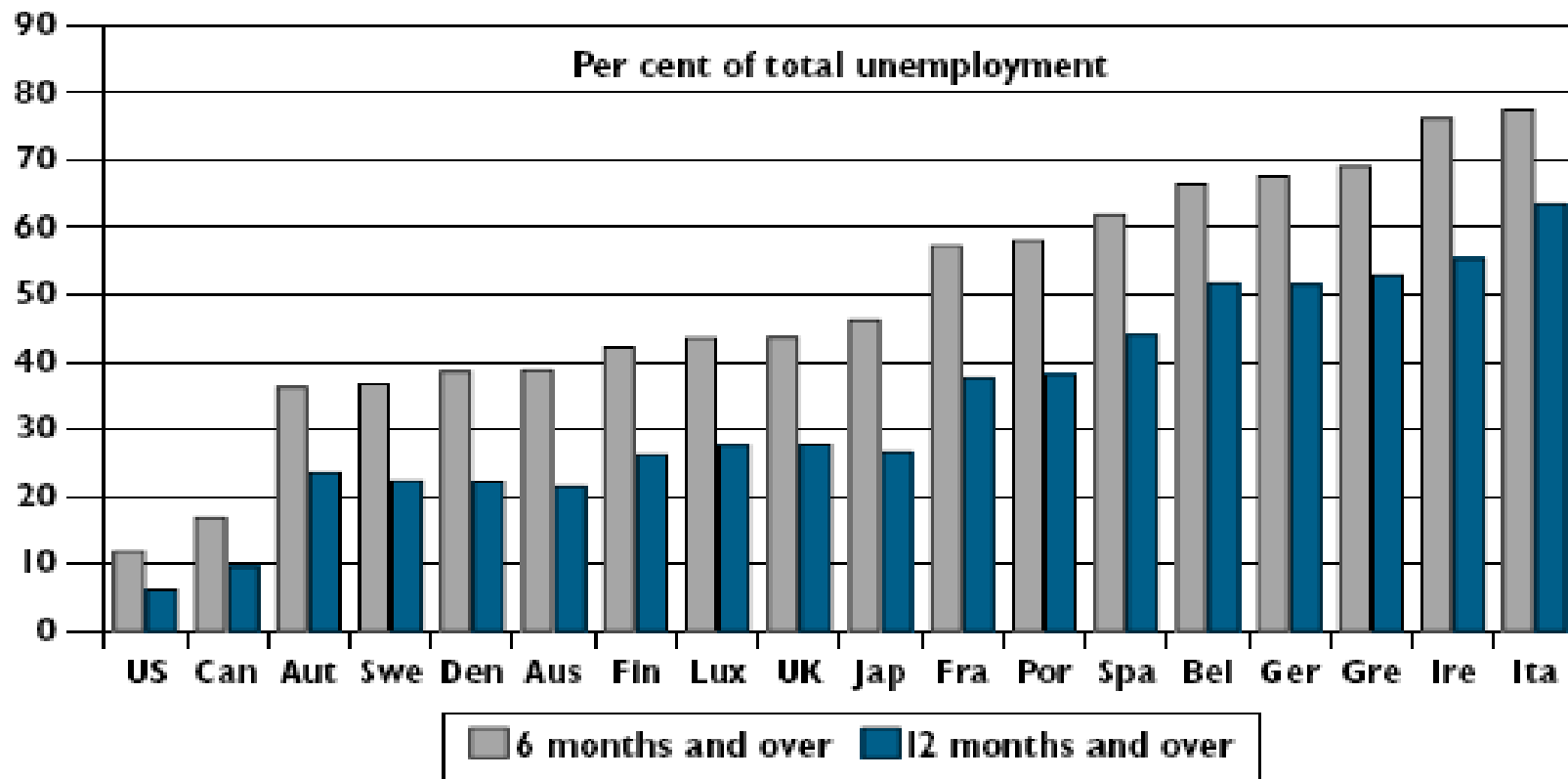
European Unemployment Rates

Britain has one of the lowest unemployment rate among the EU countries. In October 2005, these were:

- UK: 4.7%
- Ireland: 4.4%
- Italy: 7.7%
- Spain: 9.4%
- France: 9.9%
- Germany: 11.7%
- Euro Area: 8.6%
- USA: 5.1%

Long Term Unemployment

Chart 3.6: Long-term unemployment, 2001

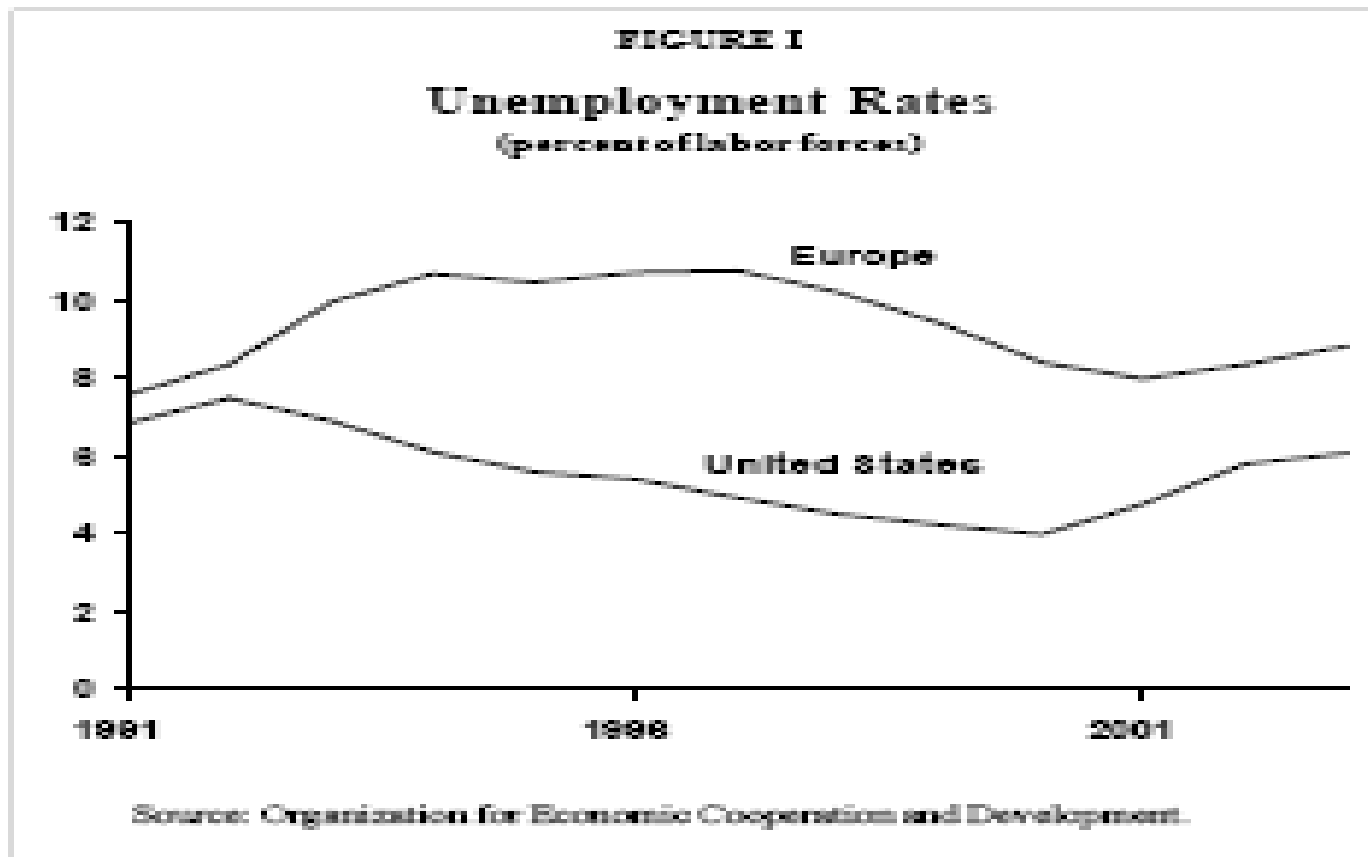


Source: OECD 2002a.

Note: Data for Germany (2000) and the Netherlands (1999).

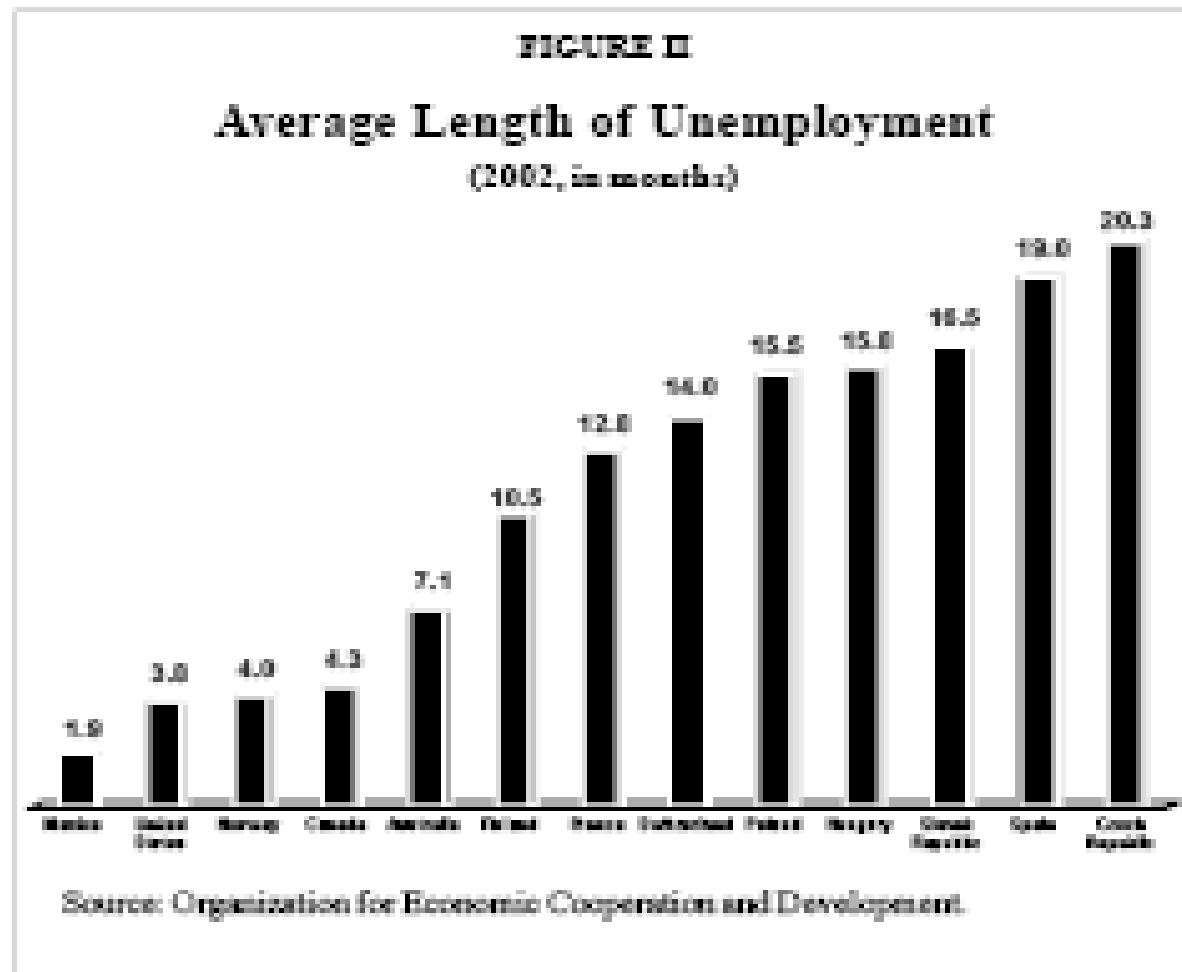
US and European Unemployment

Over the past 12 years, the US's worst rate of unemployment was better than Europe's best rate

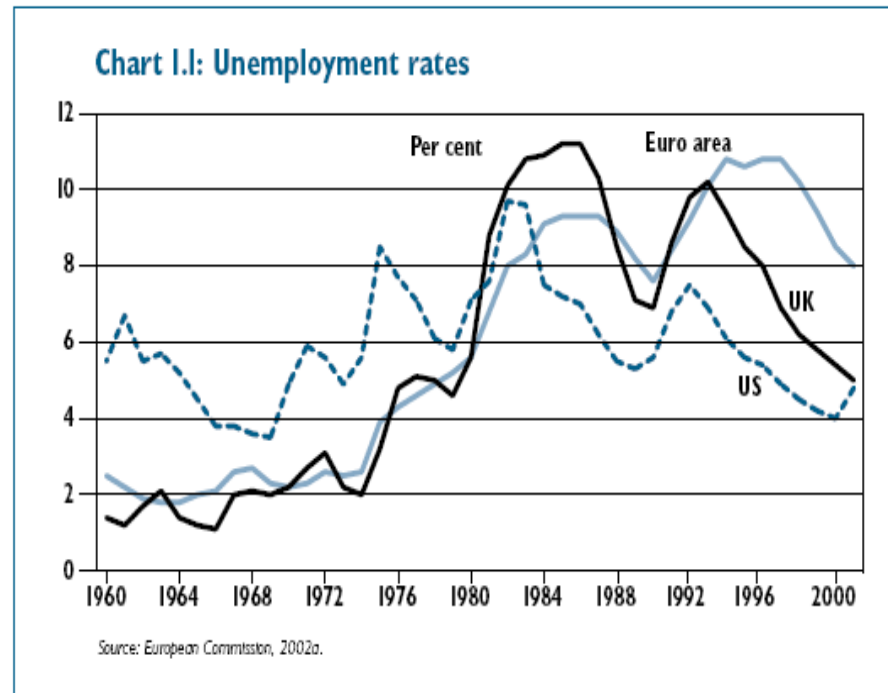


US and European Unemployment

The duration of unemployment in the USA is much lower than in Europe



US and European Unemployment



Recent Economic Shocks

In the 1960s and the 1970s, the US had a higher unemployment rate than the UK and the Euro area. Since then, these economies have been hit by a number of shocks:

- The decline in productivity in the 1970s
- The oil price shocks of 1973 and 1979
- The rise in interest rates in the 1980s
- The skills-based change in labour demand of the 1990s
- The dismantling of the Soviet Union and the collapse of communist Eastern Europe

Coping with shocks

- Shocks explain the rise of unemployment since the 1960s
- But whether the rise in unemployment, following an economic shock, becomes a permanent feature of an economy depends upon its labour market institutions
- Countries with flexible labour markets prevent temporary increases in unemployment from becoming structural (USA and the UK)
- Countries with inflexible labour markets cannot prevent temporary increases in unemployment from becoming structural (Germany, France)

Why Are European Unemployment Rates Higher than in the USA?

- More Generous Benefits
 - The Replacement Rate (RR) in the US is 25% - 29%
 - Belgium (51%), France (58%), Denmark (71%)
- More Months of Benefits
 - In the US, benefits dry up after 6 months
 - In Europe, they continue into second and third years of unemployment

Why Are European Unemployment Rates Higher than in the USA?

Wage Inflexibility

- In the US, wages respond to economic conditions: in a recession, wages fall checking the rise in unemployment
- In Europe, with greater unionisation, wages are more inflexible: in a recession, wages are rigid, so entire burden of adjustment falls on unemployment

Why Are European Unemployment Rates Higher than in the USA?

High Employment Costs

- In Europe, it is very costly to dismiss workers: so firms are reluctant to hire
- In the US, workers can be laid off at little cost so firms are willing to respond to demand increases by employing more workers

Germany: The Sick Man of Europe

- During the 1950s and the 1960s, Germany succeeded in rebuilding its economy. But during the 1970s, Germany introduced a very generous welfare state (*Sozialstaat*)
- This required high taxes on German employers to pay for generous:
 - Pensions
 - Unemployment benefits
- Trade union power meant that wages outstripped productivity
- Consequently, unit labour costs in Germany soared

Collapse of Communism

- The collapse of communist Eastern Europe meant there were at least four countries bordering Germany with strong engineering skills and low wages
- Consequently, German industry began to relocate production in the Czech Republic, Poland, and Slovakia
- Today, although German industry is a strong exporter, the location of production outside Germany means that a strong industrial performance hardly dents German unemployment