Yves Mersch: Tackling unemployment in Europe – increasing mobility, enhancing flexibility, optimising education

Keynote speech by Mr Yves Mersch, Member of the Executive Board of the European Central Bank, at the University of Luxembourg, Luxembourg, 26 September 2014.

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Ladies and gentlemen,

First of all: congratulations to all doctoral students, whose graduation we are celebrating today!

I am confident that you have a bright future ahead of you, as you stand well prepared to enter the labour market and to find jobs that match your skills – be it in academia, in the private or public sectors, here in Luxembourg or elsewhere.

Holding the relevant qualification is a precondition for receiving a suitable job offer. However, it might not always be enough to secure a job. In several European countries, prospects are rather dismal, especially for young people.

I am aware that unemployment may not be the most obvious challenge to talk to you about on such a celebratory occasion. It is, however, a major concern for the euro area. And I am convinced that well-educated people like you can really make a difference.

High unemployment in the euro area – merely a temporary phenomenon?

Temporary rises in unemployment rates are typical of cyclical downswings.

Such cyclical increases in unemployment are distressing for those affected and can have dire consequences, but they tend to reflect a transitory downturn in labour demand and do not necessarily have a strong structural component.

Firms that are uncertain about the strength of the recovery are unlikely to invest or to rehire workers. At low interest rate levels and high labour market rigidities, firms tend to favour capital intensive investments over hiring.

Yet, developments during the second recessionary episode in Europe differ from those observed at the beginning of the crisis. During the Great Recession, unemployment rose, as there was a shortage of vacancies. However, during the second recessionary dip, unemployment increased, although aggregate vacancy rates remained close to long-term averages.

In addition, the second recessionary period led not only to extensive, but also to very persistent job losses in some euro area economies. The proportion of people in long-term unemployment rose substantially. This is particularly worrisome, as it reduces the chances that they will be rehired: if workers are unemployed for a long period of time, their skills might simply erode. Long spells of unemployment may thus easily turn into structural unemployment.

Indeed, the mere fact that firms are willing to hire, but people willing to work are unable to find a job is already indicative of structural factors playing a role. Estimates suggest that structural unemployment in the euro area, which was already high prior to the crisis, rose by about 17% from 2008 to 2013.[1] Structural unemployment is not only distressing for those

[1] The European Commission, the Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF) use different estimation methods, resulting on average in structural unemployment being estimated at 8.8% in 2008 and 10.3% in 2013.

affected, but can have a substantial impact on potential output in the longer term. It is essential, therefore, to avoid hysteresis effects from rises in spells of long-term unemployment.

Particularly in countries that were hard hit, a large part of the decline in employment can be attributed to certain sectors. For instance, in Estonia, Ireland and Spain, the previously oversized construction sectors had to downsize substantially. The Spanish construction sector alone has accounted for around half of all job losses in the country since the start of the crisis. Moreover, such a collapse in the construction sector has an enormous impact further down the production chain. So, the number of people affected – for instance those providing building materials or real estate services – is estimated to be much greater than the 1.8 million who lost jobs in the construction sector.

The resulting mismatch between the skills offered by unemployed workers and those that employers require explains why vacancies are not filled, despite people being willing to work. In fact, skills mismatch has increased noticeably in the euro area and seems to be becoming more entrenched.[2]

Potential solutions to increase high qualified employment

If labour market developments are so heterogeneous across countries, why don't the unemployed simply move to places where the demand for labour is higher?

Indeed, labour mobility is a powerful tool for tackling high localised unemployment levels and alleviating emerging bottlenecks in faster-growing euro area economies. That is why labour mobility is a core element of a successful currency union. It leads to a better match between workers' skills and employers' demands. In economic jargon, it aids factor re-allocation by moving labour to where it is needed, which in turn contributes to overall growth in a monetary union and acts as an effective adjustment mechanism.

So, how does Europe fare in terms of labour mobility? The free movement of workers is a fundamental right enshrined in the Treaty on the Functioning of the European Union. But how much use do citizens make of this right in practice?

Since the enlargement of the European Union (EU) in 2004, labour market mobility has certainly risen, albeit from very low levels.[3] [The number of EU workers residing in another EU country rose from 4.7 million in 2005 to 8 million in 2013, representing an increase from 2.1% to 3.3% of the total labour force.] The crisis boosted intra-EU mobility. Some studies suggest that the migration response to the crisis might have been even stronger in the EU than in the United States.[4] This is quite remarkable given that the United States is often taken as a benchmark for mobility.

Moreover, it has sizeable macroeconomic effects: estimates suggest that post-enlargement mobility flows over the period 2004–09 increased the GDP of the EU15 by around 1%. The impact on the GDP of major destination countries for migration, such as Ireland, Spain, Italy and the United Kingdom was even higher.

Increased labour mobility is certainly good news – both for originating and destination countries. Another piece of *potentially* good news is that the level of education that migrants

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2 Ad hoc task force of the European System of Central Banks, "Comparisons and contrasts of the impact of the crisis on euro area labour markets", *Occasional Paper Series*, ECB, Frankfurt am Main, forthcoming.

3 *OECD Economic Surveys: European Union 2014*, http://www.oecd.org/eco/surveys/economic-survey-european-union.htm.

4 Jauer, J., Liebig, T., Martin, J. and Puhani, P., "Migration as an adjustment mechanism in the crisis? A comparison of Europe and the United States", *OECD Social, Employment and Migration Working Papers*, No 155, http://www.oecd.org/eu/Adjustment-mechanism.pdf.

bring to their destination countries has improved. With highly-skilled people willing to move for work, skills shortages in destination countries could be compensated for by workers emigrating from other countries. At least, this is how it should work ideally. What is worrying, however, is that many intra-EU migrant workers are employed below their skills level. The resulting underutilisation of human capital shows that reforms are needed to improve the efficiency of cross-border mobility in order to fully reap the benefits of workers' migration.

One issue is that recognition of qualifications remains uneven across EU Member States. According to a recent survey[5], current procedures that tend to be cumbersome could easily be replaced by more automatic ones: more than 90% of requests submitted result in the qualifications being recognised.

But even if their qualifications have been recognised, migrants might simply not be able to take up a position matching their level of education owing to lack of language skills. More training in this area would certainly be welcome.

Beyond efforts at Member State level, the reformed European Social Fund could be instrumental in this respect. Among other things, its objectives include investment "in education, skills and lifelong learning", as well as measures for "promoting employment and supporting labour mobility". It is up to the European Commission and the Member States to make the most out of the opportunity for mobility through operational programmes, such as language courses or exchange programmes.

Another barrier to workers moving from one country to another is that they are uncertain as to what will happen if they cannot find employment immediately. Unemployment benefits are transferable only to a limited extent. EU law has been adjusted accordingly and now needs to be implemented rigorously. The same applies for the transferability of pension rights.

To summarise, adjustment through mobility is not merely a theoretical concept, but a European reality. However, there is scope for both more inter-regional and more inter-country labour mobility.

Mobility is not the sole answer, though. After all, employment will rise once firms are willing to hire. And they will do so if conditions are favourable. While policy-makers cannot interfere with employers' decisions, they can certainly provide the right setting and eliminate barriers to more efficient labour markets. Euro area countries simply need to achieve the labour market flexibility that is compatible with membership of a monetary union.

Traditionally, policy-makers have focused on passive labour market policies, such as unemployment benefits that are de-linked from incentives to find a job. In my view, such policies should be complemented by more active policies, such as job-search assistance and targeted productivity-enhancing training measures to foster employability.

To ensure sustainable economic development, reforms are necessary and beneficial for countries that are currently facing high unemployment rates. Countries with more rapidly ageing populations also need to prepare, as they might soon face bottlenecks in labour supply. Some of these countries are already confronted with skills shortages. Just to give you an example of the implications: according to an OECD survey, potential GDP growth in Germany could decline to below 1% soon after 2020 as a result of an ageing population and skills shortages.[6]

Once I met a boy who said that his professional ambition was to become a pensioner like his grandfather. When I explained that this was related to age, he said that alternatively he

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5 OECD Economic Surveys: European Union 2014, http://www.oecd.org/eco/surveys/economic-survey-european-union.htm.

6 *OECD Economic Surveys: Germany 2014*, http://www.oecd.org/eco/Germany-Overview-2014.pdf.

would accept to be an unemployment beneficiary like his father. Sadly, today he is in and out of prison.

You see how wrong mind sets on fundamental values like work lead to social disruption. The same applies to the belief that you must only make an effort once and then live off your diploma for the rest of your life. Technological and demographic changes affect skill renewal and knowledge transmission.

More frequent skill upgrades in life cycles and better social usage of the swelling so-called non-productive age cohorts are challenges to intergenerational knowledge transmission.

The fraction of the elderly in the population will increase tremendously, while the fraction of those who produce resources is going to decline. This overall loss in productivity will also affect capital, rates of return on capital will go down at a moment when pension funds are already stretched. This is known under the catch phrase “asset market meltdown”. Even in Luxembourg, the annual growth rate of GDP per capita, or better per employee, has strongly decreased.

The question is, can you mitigate the effects of ageing societies by a rise in human capital? Research at Goethe University has shown that “the projected fall in the rate of return on capital of 0.8 p.p. would be just 0.5 p.p. in the case of adjustments in human capital through better education.”

Life-long learning, therefore also includes making better social use of the old. A University in an environment of finite financial resources has to address the challenge of including vocational training in its strategic spanning, in order to reap organisational and logistic gains in efficiency. A better use of facilities, resources and synergies increase financial efficiency and extend the sense of ownership of the University in the population at large. Of course, we must not forget the priority task of a University and the principle that quantity cannot replace quality.

Striving for excellence must remain the guiding principle, especially in a country where the risks of complacency rise by the day.

Conclusion

On that note, I shall draw to a close.

Unemployment in the euro area remains at unacceptably high levels. In order to tackle it effectively, we need to embark on a triad of measures: increased mobility, enhanced flexibility and optimal education.

And this is why, at the beginning of my remarks today, I said that well-educated, highly-skilled people like you can make a difference.

So, let me conclude by wishing all of you a very successful 2014/2015 academic year! Thank you to the departing President Rolf Tarrach, and all the best to the incoming President Rainer Klump.