Unemployed in Europe

The most vulnerable Europeans were also the most susceptible to losing their jobs, which exacerbated inequality in the region

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THE MOST fragile groups in the European labor market—young, low-skilled, and temporary workers—suffered the most during the global and regional economic crises. And if they remain unemployed for too long, they are likely to lose their skills, become discouraged, and withdraw from the workforce. Unemployment among these groups has aggravated income inequality and runs the risk of shredding Europe's social fabric, threatening its public finances, and inhibiting growth.

To find out how labor market developments after the crisis affected inequality in Europe and what can be done to help, we looked at what caused income inequality in the Organization for Economic Cooperation and Development countries—for which a strong set of inequality data are available—in the quarter-century (1980–2005) before the recent global economic crisis. Extrapolating from the precrisis experience, we found that despite the social safety nets Europe is famous for, the crisis exacerbated inequality in the region, mainly by increasing unemployment and inhibiting job creation. Moreover, as the recovery takes hold, how it plays out globally and in Europe itself—which income groups benefit the most—will determine what happens to inequality on the continent. A jobless recovery could further worsen economic disparity and undermine both economic performance and social cohesion.

No surprises

Overall, the rise in unemployment during the crisis increased inequality by an estimated 2 percentage points in the euro area as a whole, and by as much as 10 percentage points in the periphery countries—Greece, Ireland, Portugal, and Spain—where the labor market situation deteriorated much more sharply. The crisis also led discouraged workers to drop out of the labor force, a factor that is likely to have further exacerbated income disparity. On the other hand, social safety nets are likely to have cushioned the impact of unemployment on inequality.

Inequality went up in most euro area countries as the rise in unemployment rates further widened the gap between rich and poor. Spain and Ireland, in particular, are estimated to have suffered the largest deterioration in income distribution, with income inequality rising by 20 percentage points and 11 percentage points, respectively. This reflects surging job losses as construction sector activity contracted sharply after housing bubbles burst, leaving many low-skilled workers without jobs. Close to half of the unemployment contribution to inequality in these countries can be attributed to long-term unemployment. By contrast, inequality barely moved in Germany and the Netherlands: the unemployment response to declining output was unusually muted because of part-time work programs that supported job retention in anticipation of a rebound.

Within Europe, cross-country differences in income inequality reflect the interplay of labor-market developments, education levels, and social expenditures. In general, the evidence confirmed expectations. Higher unemployment, long-term unemployment, and a two-tier employment system of temporary and permanent workers all ***worsen inequality***. And social safety nets, including unemployment benefits and welfare payments; more education; and better job opportunities for vulnerable groups who do not easily find jobs—especially women and youths—***all reduce inequality***.

What to do

European countries can take a number of steps to protect vulnerable groups from unemployment and help reduce income inequality:

- ***rebalance employment protection***—with a view to *supporting job creation*—by relaxing protection for regular workers while enhancing it for temporary workers, who are generally the last hired and first fired;
- ***avert long-term unemployment***, through *job search assistance, training, and incentives for private sector employment*;
- ***improve youth access to the labor market***, by integrating employment services and the education system through outreach programs, training, apprenticeships, and access to job-search assistance measures;
- ***attract second-income earners to the labor force***, by enhancing child care support and allowing women to file their labor income separately from their husbands in countries with joint family taxation;
- ***allow wages to be more aligned with productivity*** to provide firms with better incentives to invest and create jobs; and
- ***foster competition and a more business-friendly environment*** by removing entry barriers and reducing operating restrictions in sectors such as services and retail and network industries.

Only a healthy recovery accompanied by job creation will improve income distribution and strengthen social cohesion and political sustainability of growth. Accelerating jobs recovery through far-reaching labor and product market reforms is essential to prevent the buildup of long-term unemployment, especially for those groups that were hit the hardest. ■

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This article is based on a forthcoming IMF working paper, "Unemployment and Inequality in the Wake of the Crisis."