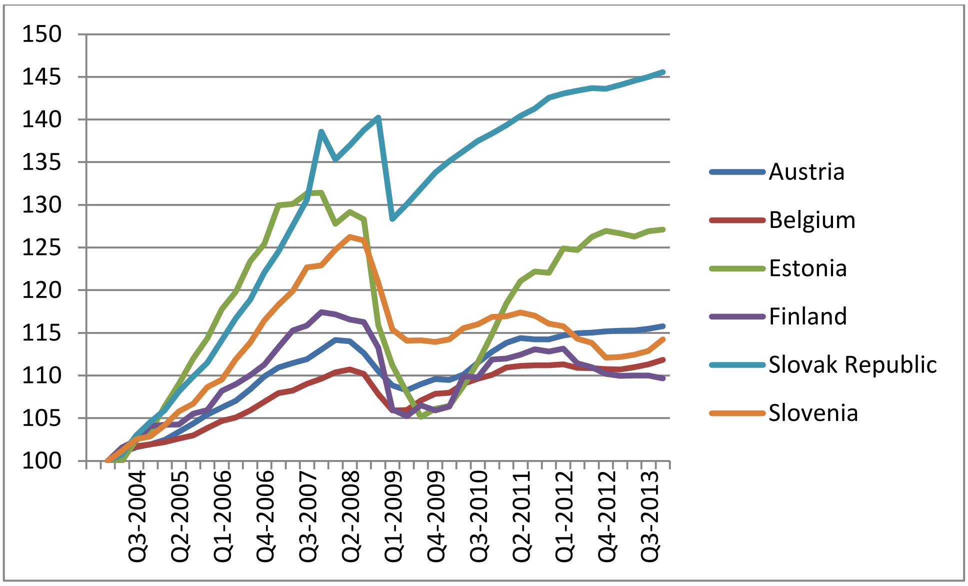
Paper proposal for the NBS-IZA-CELSI conference on European Labour Markets and the Euro Area During the Great Recession: Adjustment, Transmission, Interactions

The impact of internal devaluation, participation in global value chains and active labour market policy in small euro member countries

Zuzana Brixiova (ADB, Abidjan and IZA) and Andreas Wörgötter (OECD, Paris; IZA and University of Technology, Vienna)

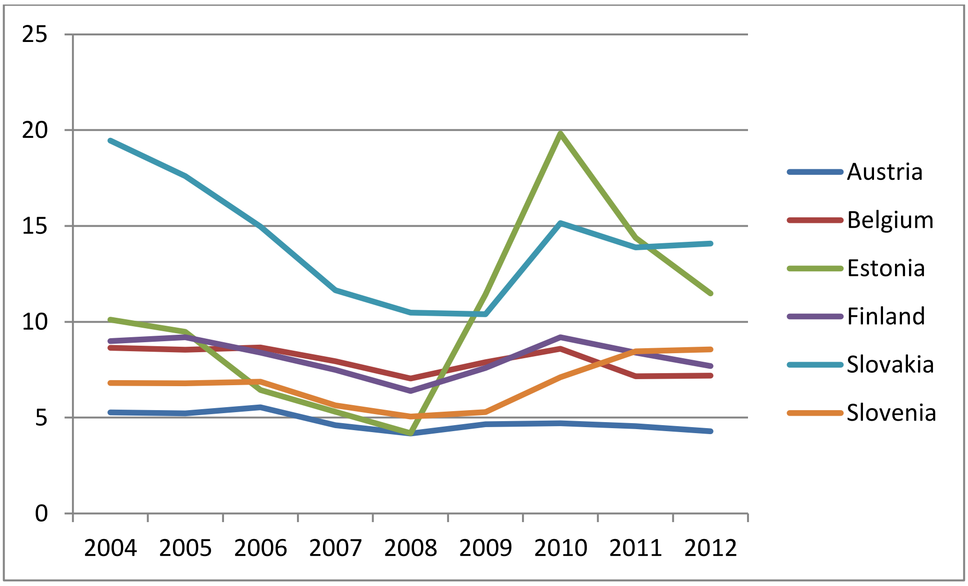
The recovery from the great recession in small euro area member countries without a sovereign debt problem (Austria, Belgium, Estonia, Finland, Slovenia and Slovakia) is strikingly different (Figure 1).

Figure 1: GDP (2004q1=100)



Differences are also considerable for the unemployment rate (Figure 2).

Figure 2: Unemployment rate (ILO definition)



There some very clear stylized facts visible from the developments of GDP and unemployment:
1) The Okun relationship varies both over time and between countries
2) Catch-up countries are "big movers", experiencing big changes in output and unemployment
3) Some countries seem to be able to low and constant, despite high fluctuations of output
4) There are also a few country specific peculiarities:

Austria has kept the pole position of the lowest unemployment rate and further advanced its lead over other high performers

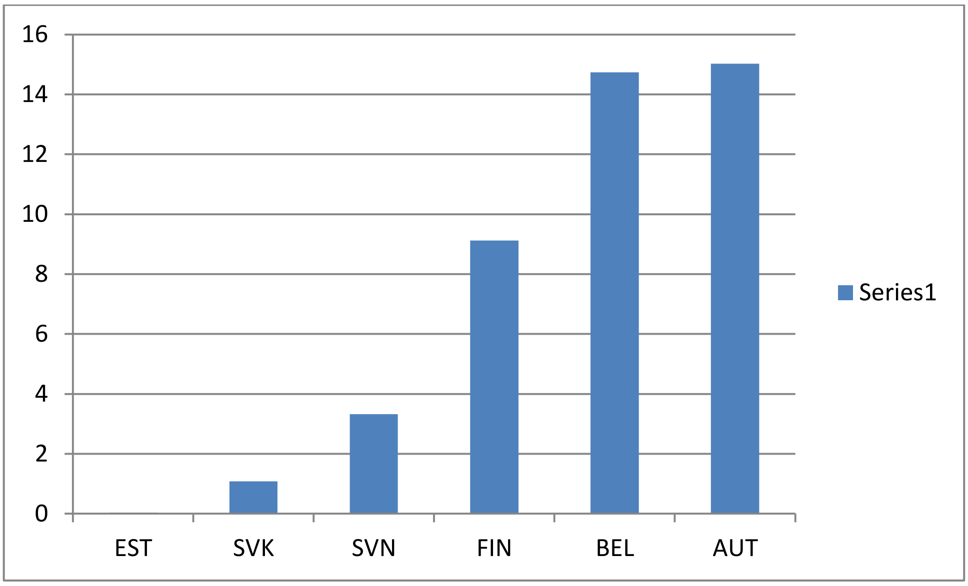
Estonia has not clawed back the whole unemployment increase during the post-crisis recovery and Slovakia has not lost all what it gained before the crisis

Finland could reduce unemployment despite a "double-dip"

Slovenia has limited the unemployment increase despite a big "double-dip"

There also big differences in spending on active labour market programmes (Figure 3), which are consistent to some of the variations of the Okun relationship. Finland, Belgium and Austria seem to be able to minimise skills-mismatch and facilitated the recovery by high spending on ALMPs. Estonia and Slovakia on the other hand depend solely on growth as a source for exit opportunities from unemployment.

Figure 3: Spending on active labour market programmes per unemployed (1000 USD PPPs), 2010



The proposed paper will replicate the empirical evidence with a model, which combines the option of participating in a global supply chain with skills matching on the labour market. This means the interaction of two search models, one for technologies fitting available resources and the other matching job-searchers with vacancies. The bottom-line is to shed some light on the trade-off between flexibility/volatility and growth.