Labour Economics 34 (2015) 1–12

Contents lists available at ScienceDirect

Labour Economics

journal homepage: www.elsevier.com/locate/labeco

The Great Recession was not so great ☆

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HIGHLIGHTS

- The Great Recession is characterized by an unprecedented GDP-decline.
- This paper analyzes labor market data from 20 OECD countries.
- Young workers are the most affected by the Great Recession.
- Economic growth is needed to reduce unemployment.
- Economic growth has a "one size fits all" character.

ARTICLE INFO

Article history:
Received 30 November 2014
Received in revised form 23 January 2015
Accepted 3 February 2015
Available online 11 February 2015

JEL classification:
J64

Keywords:
Great Recession
Unemployment
Employment

ABSTRACT

The Great Recession is characterized by a GDP decline that was unprecedented in the past decades. This paper discusses the implications of the Great Recession analyzing labor market data from 20 OECD countries. Comparing the Great Recession with the 1980s recession it is concluded that there is a high cross-country correlation of the unemployment rates over the two recessions indicating that some labor markets are more vulnerable to fluctuations in economic growth than others. Young workers are the most affected by the Great Recession both in terms of unemployment rates as well as employment rates. For prime age workers employment rates were also affected but for older workers the Great Recession did not have a large impact. To analyze how economic growth and labor market institutions have affected unemployment two types of models are estimated. The main conclusion is rather straightforward and has a "one size fits all" character: to reduce unemployment and create jobs economic growth is needed.

1. Introduction

For several decades economic growth in OECD countries has been fluctuating but it was rarely negative. The Great Recession is characterized by an unprecedented decline of GDP. In 2009, in almost every OECD country there was a negative growth of real GDP of a couple of percentage-points. The big negative economic shock led to a sharp increase of unemployment in many though not all countries. In terms of unemployment rates (unemployment as a percentage of the labor force) young workers are the most affected by the Great Recession. For young and prime age workers employment rates (employment as a percentage of the working age population) were also affected but for older workers the Great Recession did not have a large impact. This paper provides a description of the evolution of GDP growth, employment and unemployment over the past decades and relates the evolution of labor market outcomes to economic growth and cross-country differences in unemployment rates to labor market institutions.

The set-up of the paper is as follows. The next section provides details about the Great Recession mainly in terms of unemployment rates and economic growth. The Great Recession is compared with the 1980s recession in terms of who is hurt the most, distinguishing workers by gender, age and education. In terms of unemployment there are large cross-country differences in the effects of the Great Recession. Nevertheless, compared to earlier recession the impact of the Great Recession is not different. In countries where unemployment was high after earlier recessions unemployment is also high after the Great Recession. In terms of unemployment rates, young workers and

☆ This paper is an extended version of my Presidential Address of the European Association of Labour Economists (EALE) in Ljubljana September 2014. I would like to thank Tito Boeri, Robert Dixon, Matteo Picchio and an anonymous referee for comments on a previous version of the paper and Jakub Cerveny for his assistance in collecting the data.

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http://dx.doi.org/10.1016/j.labeco.2015.02.001

low educated workers are the most affected by the Great Recession. Nevertheless, within countries unemployment is highly correlated between age groups and according to educational attainment. Section 3 discusses labor market institutions where the focus is on three types: unemployment insurance benefits, unions and wage bargaining and employment protection legislation. Despite the fact that large fluctuations in economic growth are a recurrent phenomenon in the past decades labor market institutions did not change much over time. The effects of labor market institutions on the functioning of the labor market have been investigated but the effects for some institutions are clearer than for others. Reforms of labor market institutions are considered to be important but these reforms occur only every now and then and are rarely substantial. Section 4 is on how to make sense of all this. There are two basic types of empirical models of unemployment: Okun's relationship that relates unemployment change and economic growth and Nickell's relationship that relates unemployment rates to labor market institutions. Section 5 presents an exploratory analysis of both empirical models. The effects of labor market institutions and economic growth on unemployment rates are quantified by estimating extended versions of Okun's relationship and Nickell's relationship. In Okun's relationship labor market institutions are allowed to be determinants whereas in Nickell's relationship economic growth is allowed to affect unemployment rates. Okun's relationship is rather stable, and only few labor market institutions affect it. The same holds for Nickell's relationship. Both in Okun's relationship and Nickell's relationship economic growth is the dominant determinant of the evolution of unemployment rates. Changes in labor market institutions might also be important, but the effects are less related to booms and busts. Therefore, the clearest remedy for unemployment seems to be economic growth. This is most relevant for young workers. The concluding section argues why the Great Recession was not so great and why the labor market consequences of the Great Recession are not over yet.

2. The Great Recession — what was it like?

2.1. Unemployment and growth

Because of data availability the focus of the analysis is on 20 OECD countries, which for descriptive purposes are often aggregated into four groups of countries: Euro-countries, other European countries, non-European countries and the United States.[1] Table 1 gives an overview of the evolution of unemployment rates and real GDP growth for these four country blocks where five calendar time periods are distinguished: Prologue (1970–1980), 1980s Recession (1981–1983), Great Moderation (1984–2008), Great Recession (2009) and Post-Great Recession (2010–2013). In terms of unemployment rates the Great Recession does not stand out. In fact, the average unemployment rates in the Great Recession are identical for some country blocks to the Great Moderation. In terms of economic growth the Great Recession clearly stands out. Furthermore, the growth rates in the Post-Great Recession Period are comparable to the growth rates in the 1980s recession period.

Fig. 1 provides annual information about unemployment rates and economic growth over the period 1970–2013 for the four country blocks. There is a strong correlation between the fluctuations in the unemployment rate in the four country blocks but there are also clear differences. In the US, unemployment rates are fluctuating a lot but over the whole of the calendar time interval there is no clear trend. For the other countries in the early 1970s the average unemployment rates are much lower than later on. The Euro-countries on average faced the biggest increase. Whereas in the early 1970s the average unemployment rate in the Euro-countries was substantially lower than in the US, not much different from the non-European countries and only slightly above the non-Euro European countries, there was a strong increase in unemployment rates in the course of the 1970s and early 1980s. From the early 1980s onwards the average unemployment rate in the Euro-countries is the highest. The immediate impact of the Great Recession in terms of unemployment rates is most severe in the US, but whereas in the US unemployment rates declined after the Great Recession it kept on growing in the Euro-countries. The lower

Table 1
Unemployment rates and real GDP growth; descriptive statistics by groups of countries and time periods.

	Europe				
	Euro	Non-Euro	Non-Europe	US	Total
Unemployment rate (%)					
1970–1980 Prologue	4.3	2.5	3.3	6.4	3.8
1981–1983 1980s Recession	9.0	5.3	6.1	9.1	7.5
1984–2008 Great Moderation	9.0	5.3	6.4	5.8	7.4
2009 Great Recession	9.0	6.0	6.4	9.4	7.8
2010–2013 Post-GR	10.4	6.3	6.1	8.7	8.4
1970–2013	8.0	4.8	5.6	6.5	6.6
Annual growth real GDP (%)					
1970–1980 Prologue	4.0	2.5	3.5	3.2	3.5
1981–1983 1980s Recession	1.1	1.3	2.3	1.8	1.4
1984–2008 Great Moderation	2.8	2.5	2.8	3.2	2.7
Great Recession	−4.6	−3.9	−1.7	−2.8	−3.7
2010–2013 Post-GR	0.5	1.6	2.3	2.3	1.2
1970–2013	2.6	2.2	2.8	2.9	2.5

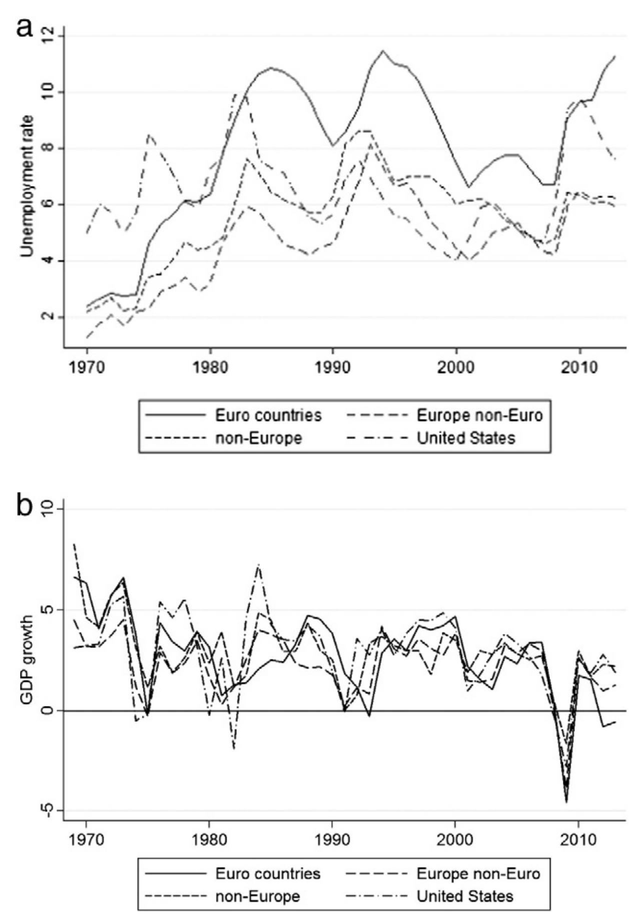

Fig. 1. Unemployment rates and GDP growth 1970–2013; country blocks. a. Unemployment rates (%). b. Annual GDP growth (%).
Source: OECD Statistics.

[1] The Euro came virtually into existence 1 January 1999 and from 2002 onwards Euro coins and notes began to circulate. The countries that adopted the Euro are grouped into Euro-countries from 1970 onwards.