EUROPEAN LABOUR MARKET BOTTLENECKS: STRUCTURAL ASPECTS

Companies in the euro area report record-high levels of labour shortages. These are partly cyclical in nature but structural factors also play a role. Last year's annual investment survey of the European Investment Bank shows that the availability of staff with the right skills is the second most important factor weighing on long-term investment decisions in the EU. Structural labour shortages can weigh on potential GDP growth through its impact on capital formation, innovation and productivity. Economic and, in particular, education policy including vocational training and lifelong learning schemes will have to make sure that, going forward, the available skills, both in quantity and quality, fit the evolving needs.

Companies in the euro area report record-high levels of labour shortages. It is a manifestation of the strong recovery after last year's deep and sudden recession. Sectoral mismatches in the demand and supply of labour also play a role, with people having left, perhaps permanently, sectors such as transport, tourism and leisure that had suffered more than others from the lockdown measures.

Labour shortages can act as a speed limit on growth – it looks like we are in such a phase now – and lead to an acceleration of wage growth.[1] However, labour shortages can also be structural. This can be related to the size of the labour force as well as its quality. Population ageing is a key driver of the former, causing a net reduction in the labour force as older cohorts who retire outnumber the younger ones joining the labour market. Labour shortages can also be quality-related and hence reflect a shortage of the right skills. Companies find it hard to recruit people with the right profile. Providing a compensation package well above the going market rate could solve the issue at the single company level but that just shifts the problem to companies that have seen people leave. They may have no other option than to accept a certain degree of skill mismatch, by hiring people that are over- or underqualified.

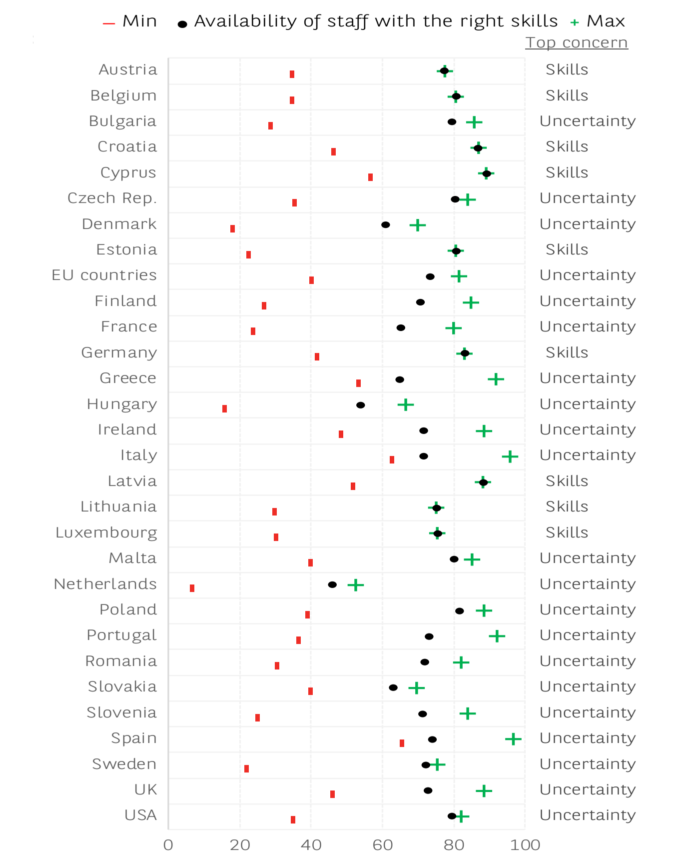
Because of skill gaps, a high number of vacancies can exist alongside high structural unemployment. This comes with a human cost – the psychological burden of being unemployed- as well as an economic cost – the opportunity cost when not being employed, the loss of skills, which makes it harder to find a new job. Structural labour shortages can weigh on potential GDP growth through its impact on capital formation, innovation and productivity. Last year's annual investment survey of the European Investment Bank reported on the factors impacting long-term investment decisions (chart 1). For the EU as a whole, uncertainty has the highest score (83.4%), whereas the availability of staff with the right skills comes next, with a score of 73.5%. For a total sample of 30 observations (29 countries plus the EU), in 76% of cases, staff availability as a factor weighing on investments, comes either in first or second place. To the extent that this effectively reduces the volume of investments, this could end up weighing on potential growth. Demonstrating this empirically is a complex task. Skill shortages as reported in business surveys may predominantly be cyclical in nature, reflecting strong economic growth, which probably comes with stronger productivity growth. Even from a longer-term perspective, these shortages may reflect that countries are doing well structurally, are very efficient and productive. Research from the European Commission concluded that *"we are not able to isolate the potentially negative impact of skills shortages based on our analysis at the aggregate level. Micro-econometric analyses based on firm-level data may be more adequate to measure this impact."*[2] Research for the UK for the period 2008-2014 on the other hand "reveals a negative direct effect of skill shortages on firm productivity."[3] Moreover, it finds negative spillover effects to related industries and proximate regions.

1. See *Euro area labour market bottlenecks: cyclical aspects, Ecoweek*, BNP Paribas, 15 November 2021.

2. Skills Mismatch and Productivity in the EU, Anneleen Vandeplas and Anna Thum-Thysen, European Commission, European Economy Discussion Paper 100, July 2019.

3. Morris, D., Vanino, E. and Corradini, C. (2020) *Effect of regional skill gaps and skill shortages on firm productivity. Environment and Planning A: Economy and Space*, 52 (5). pp. 933-952. https://doi.org/10.1177/0308518X19889634

FACTORS IMPACTING LONG-TERM INVESTMENT DECISIONS



SOURCE: EUROPEAN INVESTMENT BANK INVESTMENT SURVEY 2020, BNP PARIBAS

Skill shortages could also complicate the task of responding to new challenges like the green transition or the digital revolution, given the demand for specific skills that comes with it. However, with respect to the former and based on the EIB survey mentioned above, companies do not (yet) seem to worry that much. Amongst the "*factors impacting investment in activities to tackle the impacts of weather events and emissions reduction*", concern about availability of staff with the right skills, on average, ranks fourth out of five (chart 2).

The retirement of the baby boom generation and the entering of less numerous cohorts should, ceteris paribus, lower the unemployment rate. However, this supposes that the available skills fit the evolving needs. Otherwise, we run the risk of falling in a trap of slow growth and high structural unemployment. This would weigh on public finances and put pressure on society due to rising inequality. Economic and in particular education policy including vocational training have a key role to play in taking up this challenge. Moreover, lifelong learning schemes might retain older workers long in their job, thus reducing pressures in the labour market and on the retirement schemes.

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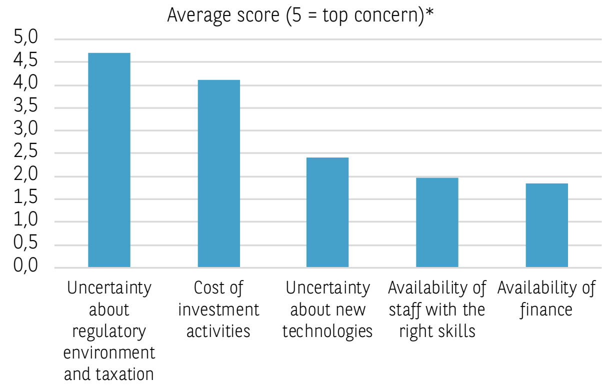
FACTORS IMPACTING INVESTMENT RELATED TO CLIMATE CHANGE



* **Countries list:** Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Rep., Denmark, Estonia, EU countries, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, UK, USA,

SOURCE: EUROPEAN INVESTMENT BANK INVESTMENT SURVEY 2020, BNP PARIBAS

> Economic and in particular education policy including vocational training and lifelong learning schemes will have to make sure that, going forward, the available skills, both in quantity and quality, fit the evolving needs.