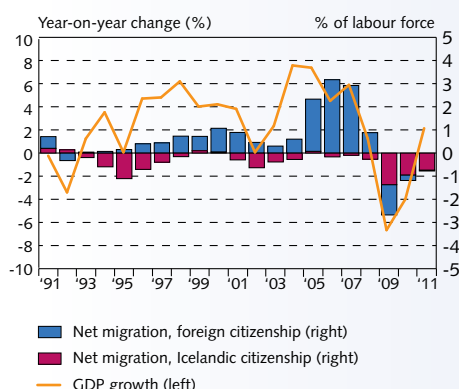


Box VI-1

The flexibility of the Icelandic labour market and migration flows

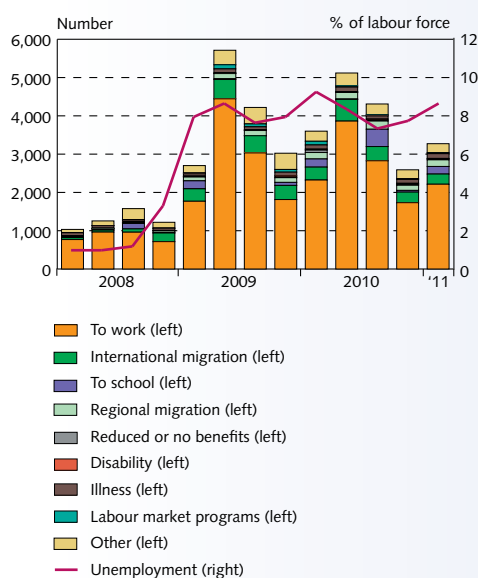
Chart 1
Labour migration and economic growth¹



1. Figures on migration for 2011 are for the first three quarters but figures on growth are for the first two quarters.

Source: Statistics Iceland.

Chart 2
Reasons for deregistrations of claimants¹



1. Reasons for deregistrations grouped under other include death, pension, illness, prison, in need of childcare, vacation, parental leave and other compensation.

Source: Directorate of labour.

Considerable flexibility still present

The flexibility of the Icelandic labour market has enabled the domestic economy to adjust to the economic crisis.¹ Labour market participation has declined, working hours have fallen, and people have emigrated. The labour force has decreased by 6.1% from Q3/2008 to Q3/2011 and the number of people in the working age group of 16-64 has decreased by 1.2%. Of the 6.1% decrease in the size of the labour force, 3.4 percentage points can be attributed to net migration of people in the age group of 16-64 and 5 percentage points to the decline in labour market participation, while other changes in the labour force have contributed to an increase of 2.3 percentage points.

The increase in immigration of foreign workers has enhanced the role of migration flows to business cycle adjustments

As Chart 1 shows, there has generally been a strong relation between migration flows and the business cycle. Icelandic nationals have tended to move to and from the country depending on economic conditions and labour demand. Foreign nationals who come to Iceland for work have increased that flexibility even further, and their contribution to the upswing of 2004-2007 was considerable. Net immigration of foreign nationals to Iceland was around 17 thousand in 2004-2008, but since then, the net emigration of foreign nationals has been around 2,700.

In 2009 the unemployment rate was 8%, and that year the net emigration totalled 4,800. Measured as a fraction of the labour force, net emigration amounted to 2.5% in 2009. Around half of those were foreign nationals, even though they constituted only 7.6% of the total population. In comparison, total emigration was around 1.1% of the total labour force in the economic recession in the 1990s, when the unemployment rate peaked at 5% in 1995. As shown in Chart 1, net emigration is considerably less now than in 2009, when it was at its highest.²

Net emigration is thus considerably greater now than in previous recessions, even when allowing for the fact that the current contraction is deeper than in previous recessions. The reason for greater emigration than in earlier recessions is probably that a large part of foreign nationals who came here to work in the economic upswing had not settled before it ended.³ Almost 50% of those who migrated from the country in excess of those who migrated to the country in 2009 and 2010 were foreign nationals. That is more than four times their share in the labour force when it peaked in the upswing.

Unemployment could have risen higher without labour migration

These emigration flows are likely to have caused the unemployment rate to rise less than it would have without them.⁴ However, it is clear that not everyone who migrated from the country was active

1. See e.g. discussion in *Monetary Bulletin* 2010/2.

2. Most of foreign nationals had left earlier in the year but were not deregistered until in the end of the year. These trends were reversed in the second half of last year and the first half of this year when more foreign nationals moved to the country than from it.

3. Most of those who came to work in Iceland during the economic upswing came from the E-8 countries (Estonia, Latvia, Lithuania, Poland, Slovakia, Slovenia, The Czech Republic and Hungary). Rules on free movement of labour became first effective for these countries on 1 May 2006.

4. Estimations of the unemployment rate excluding the effects of net migration can only be interpreted as being indicative of an upper limit of the unemployment rate. For example, if people had not migrated but had rather been registered as being unemployed and received unemployment benefits, domestic demand and therefore employment would probably have been greater than otherwise.

in the labour market. The Directorate of Labour's data on deregistration of claimants show how many unemployed workers have migrated from the country (see Chart 2). In the years 2009 and 2010, around 3,200 claimants of unemployment benefits deregistered due to emigration. Without the emigration of this group of workers, the number of unemployed workers would have been around 11% higher in 2009 and just over 10% higher in 2010, which is equivalent to the unemployment rate, as registered by the Directorate of Labour, having been higher by around a percentage point each year.