

Unemployment is the scourge, not youth unemployment per se

The misguided policy preoccupation with youth

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Key points

Unemployment is one of the key economic issues in large parts of Europe – especially in the south, which has been in recession for the last 4-5 years. In countries like Greece, Spain, Portugal and Italy, youth unemployment rates have risen to levels that are often reported as “alarming” or “shocking” in the media.

This has prompted European institutions into a flurry of activity. The Commission has launched a number of initiatives over the last year focused predominantly on young unemployed people. A further string of new measures and the speeding up of already agreed initiatives is expected to be the outcome of the European Council meeting on June 27-28th. Some of these are sensible structural measures – such as building apprenticeship programmes and assisting in better school-to-work transitions – which are likely to have a positive impact on youth unemployment in the longer term. However, most others are found wanting, or even counterproductive.

This Policy Brief argues that too much effort and political capital is being spent by the Commission and member states on being seen to be doing something quickly about youth unemployment when, in fact, the structural measures proposed will only have long-term effects. Expectations of immediate relief are running well above what can be delivered, especially at the EU level. Given the macroeconomic situation, *no* policy option will deliver a significant dent in either youth unemployment or unemployment in general.

The EU policies on the table that are supposed to have an immediate effect, such as increased lending from the European Investment Bank to SMEs for the hiring of young people, will only have a very marginal impact on youth unemployment. Moreover, this impact will come mostly to the detriment of older unemployed persons excluded from such a scheme.

Given the perceived need to ‘be seen to be doing something’, we fear that policies subsidising young workers *de facto* at the expense of older workers or, even worse, policies that subsidise older workers for not taking young people’s jobs, will proliferate.

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In fact, it is not at all clear that young people suffer more from being unemployed than older people, or even disproportionately more than older unemployed individuals. In particular, it is not clear that the much-publicised notion of a 'lost generation' with permanent 'scars' is relevant *only* to the young generation.

We end by highlighting the much-neglected policy option of encouraging labour mobility within the internal market. Although the Commission is 'upgrading and modernising' its tools, much more could be done in this area – to the benefit of the individuals concerned, the member states, and European integration in general.

The current unemployment situation¹

The headline conventional youth unemployment numbers that are widely reported do indeed paint a bleak picture of the current situation for youth. Spain and Greece are often portrayed as having half of the young population between the ages of 15 and 24 unemployed. But people familiar with labour market statistics know that the true picture is different, because most young people of this age are in school or further education and therefore are not seeking work for good reason.

'Youth' (un)employment data refer to those aged between 15 and 24. But this age group consists of two sub-groups with very different characteristics. 'Teenagers' (15 to 19 year-olds) should mostly still be in school; if not, they are likely to be very low skilled and thus would have difficulty finding a full-time job even in normal times. Fortunately, this group is rather small and has been declining in size over time (Gros, 2013).

Unemployment among those aged between 20 and 24 should be more troubling. Members of this cohort who are seeking full-time employment have typically completed upper secondary education, but have decided not to pursue a university education (or have completed their university studies early). That is why one should look at the unemployment *ratio* – the percentage of the unemployed in the reference population – rather than at the unemployment *rate* (Figure 1).

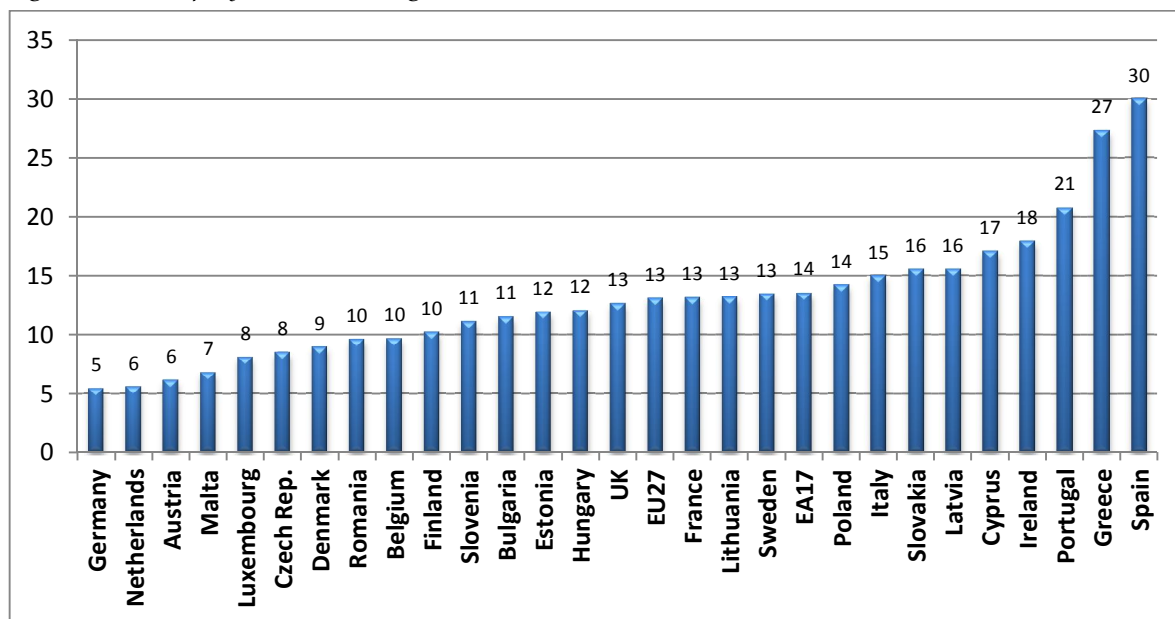
Indeed, this indicator paints a much less alarming picture than that created by the headline youth unemployment *rate* of more than 50% in Spain, or even the 66% recently reported in Greece. The youth unemployment rate in Greece does not mean that two-thirds of young Greeks youth are unemployed. Only 9% of Greek teenagers are labour-market participants; two-thirds of that number cannot find a job. The unemployment ratio among teenagers in Greece is thus less than 6%. But this statistic is not reported widely, probably because it is much less alarming.

Moreover, one should look at youth unemployment in the context of the overall labour market. In some countries, youth unemployment is much higher relative to overall unemployment. Italy constitutes the most egregious case, with a youth unemployment rate over three times higher than the overall unemployment rate. But this is not a recent phenomenon – the situation was the same even before the outbreak of the crisis. By contrast, the youth unemployment rate in Germany is 'only' 1.5 times higher than the overall unemployment rate (Gros, 2013). In fact, Figure 2 shows that for most countries, youth unemployment has been rather stable *relative* to overall unemployment. In this sense, the

¹ This builds on Gros (2013).

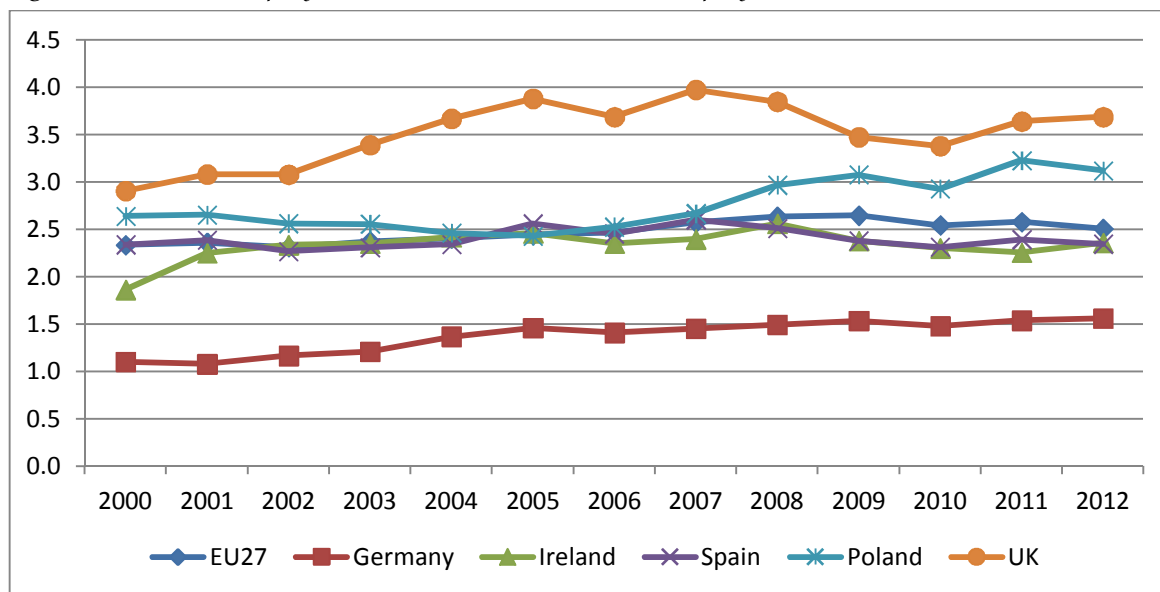
current situation is not special; in all recessions, youth unemployment increases in many countries by twice as much as general unemployment.

Figure 1. Unemployment ratios (ages 20-24), 2012



Source: Eurostat.

Figure 2. Youth unemployment rates relative to total unemployment rates, 2012

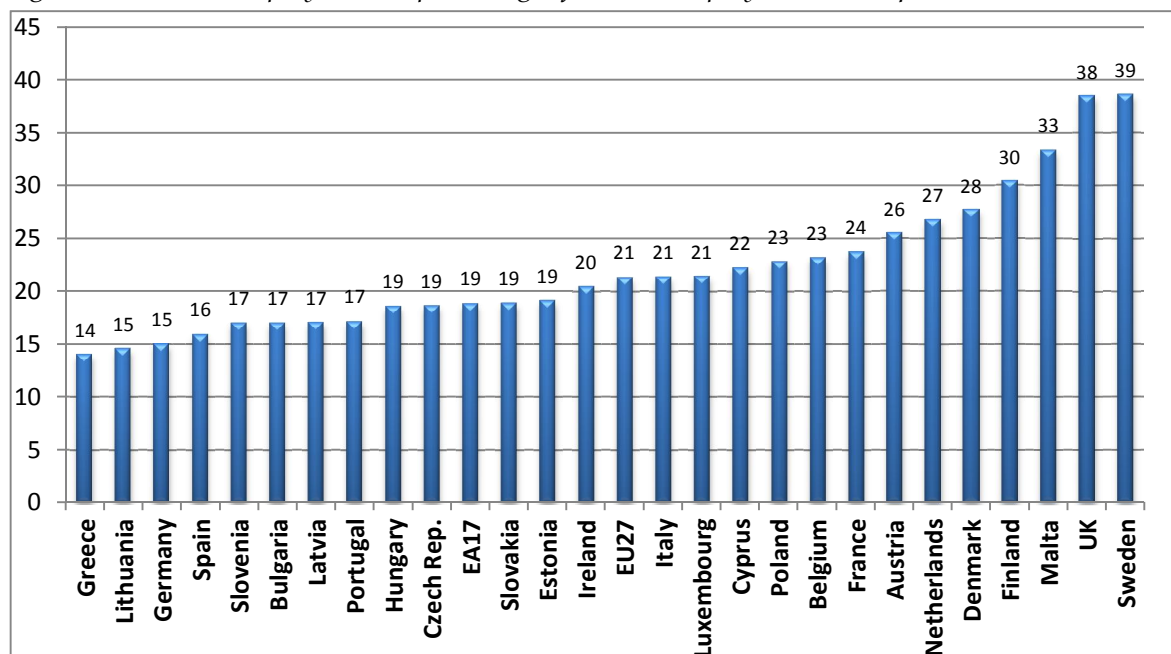


Source: Eurostat.

Finally, one must ask how much youth unemployment contributes to total unemployment. Looking at the problem in this way reveals a completely different picture from that usually presented. In those countries where the problem makes the biggest headlines (the Eurozone’s south, with Greece and Spain supposedly the worst cases), youth unemployment accounts for less than a quarter of overall unemployment (Figure 3). By contrast, youth

unemployment contributes relatively much more (about 40%) to overall unemployment in countries like Sweden and the UK. One could argue that the latter two should worry more about their youth unemployment than Spain or Greece.

Figure 3. Youth unemployment as percentage of total unemployment, 2013q1



Source: Eurostat.

Unemployment is one of the most significant risks that individuals and households face, and because of the current macroeconomic situation, unemployment is much higher than normal in many parts of Europe. This is the situation for all age groups and it does not warrant age-specific policies which, given weak overall demand, will to a large extent only shift employment around among age groups. Such policies are only relevant if one is confident that certain age groups suffer more from unemployment than others.

Which generations are 'lost'? Is unemployment worse for the young?

The fear of permanent scarring of young jobless people – turning them into a 'lost generation' – is one of the most persuasive arguments in favour of promoting policy measures that target youth unemployment specifically. If the first labour market experience is crucial for subsequent labour market participation and earnings, there might be a case for policies promoting youth employment at the expense of employment of other age groups. This could be the case if, for example, the period immediately after graduation is formative for the rest of one's career.

The Commission is increasingly mentioning scarring and the fear of a 'lost generation' together with the youth unemployment situation as an argument in its communications.

The notion of 'scars' from unemployment comes from a large body of academic literature that looks into the short- and long-term effects of unemployment spells on subsequent

labour market outcomes, in particular, on labour market participation rates and earnings.² The main question this literature seeks to address is the counterfactual of what would, on average, have happened with subsequent earnings and labour market participation had a given individual not been unemployed for some period at an earlier stage.³

The key point of relevance for public policy in the current situation is to what extent scarring is worse for younger than older cohorts, i.e. the *relative* effect rather than the precise magnitude. Unfortunately, much of the literature on this issue does not look at the effect for different cohorts, but rather only at the impact on one cohort (which, in the majority of cases, is a young one).

The predominant view in the literature is that unemployment has negative long-term effects and, when this is investigated as part of the research question, the effects are worse for older (prime age) cohorts. In their review of studies based mostly on US data, Couch and Placzek (2010) only find articles where scarring increases with age and none where the opposite is the case (when this is investigated together). Barslund (2013) also reviews studies based on European data and reaches the same conclusion.

In general, the scarring effect varies greatly from study to study. The US survey includes one study where scarring leads to a wage penalty of 8-13% after six years (with higher initial wage drops); other studies show larger scarring effects and a few show no permanent scars at all, since the initial effect on wages disappears after six years. Generally, results span the range from no long-term effect to wage penalties of up to 30-40% six years (or longer) after being unemployed.⁴

But Barslund (2013) also finds that scarring effects tend to be much smaller for studies of continental European countries compared to the US and the UK. This suggests that the US experience does not translate exactly to Europe.

There are two important qualifiers to note in relation to the findings in the literature. The first is that the average impact of scarring is likely to be smaller than that which can be inferred from published studies. This is due to publication bias – it is very difficult to get a study published which does not find a scarring effect, thus it is likely that studies that failed to find scarring stayed in the drawer. Second, the credibility of the studies depends on how well they can estimate the right counterfactual. Even if a study is carefully done using state of the art statistical methods, it can be very difficult to judge if a convincing counterfactual has been estimated.

² The term ‘scarring’ or ‘scars’ from unemployment goes back to at least Ellwood (1982).

³ This is no easy question to approach, because those unemployed at any given point in time are likely to differ from those employed in many observable and unobservable ways. To appreciate this, take as an example two persons who differ in their earnings today and where one was unemployed five years ago. This difference could be due to the disadvantage one got from being unemployed, but it could just as well be that he or she was unemployed because he or she – by way of character – was less motivated to find a job. However, the same motivational difference might also explain the differences in earnings today. Thus, the two persons would have had the same earnings difference today if some public policy had put the less motivated one into a job five years earlier and she or he would have avoided the unemployment spell.

⁴ It is important to keep in mind that our argument relies on the fact that younger workers do not seem to be harder hit by unemployment compared to older workers.

Our reading of the literature suggests that the loss of firm-specific capital (of which older workers have more than younger workers) is important to understand the magnitude of the scarring effect. Another important characteristic could be that of mobility. Older workers will more often have stronger attachments to their local area via their family relations, such as children's schooling and spouse's employment. Younger workers, on the other hand, are on average likely to be more mobile and have smaller fixed costs from moving for a new job.

In sum, the evidence suggests that unemployment spells indeed have long-term negative effects on labour market outcomes; however, there is little evidence to back the claim that young people are more vulnerable to those effects than are other age groups. Thus, 'scarred generations' might be a more accurate term to use. This severely weakens the case for measures aimed particularly at jobless youth as opposed to more general measures benefiting all age groups.

Furthermore, young people rarely have the same amount of family responsibilities (towards offspring or parents), but instead are often able to rely on their family for backup.

Against this background, the focus on 'solving youth unemployment' is misguided. While there is no doubt that the current unemployment situation is causing a lot of hardship around Europe, it is hardly a solution to shift this hardship from young to older cohorts.

Current policy initiatives without short-term effects, or only shifting the burden

The Commission has been increasingly active in presenting initiatives to combat youth unemployment. Last December saw the Youth Employment Package, and this March the Youth Employment Initiative was unveiled. Some of the elements of these packages have been agreed upon, while others are grinding their way through the system and are waiting for financing to come through in the next budget cycle.

Those initiatives which aim at structural improvement are to be applauded. Strengthening vocational and educational training systems – the Commission's call for member states to "modernise and improve their education systems" in order to reduce skill mismatches and address the problem of early school leaving (European Commission, 2013) – always makes sense. The Commission is very well placed to advance mutual learning on these topics via the open method of coordination, and it should certainly take this up as part of its core work programme. However, the Commission should spell out that such structural initiatives will not deliver immediate results. Indeed, some of these are practically irrelevant to the unemployed young population of today.

The Youth Guarantee – the poster child for efforts so far – was proposed as part of the Youth Employment Package in 2012 and was adopted by member states. It guarantees unemployed youth (up to the age of 25) access to employment, education or high-quality traineeships within four months of becoming unemployed. The European Social Funds will provide funding for this (starting from early 2014), with additional funding coming from the Youth Unemployment initiative (also to be made available in 2014). At this stage, the details of implementation, which will naturally vary from country to country, are unclear, but that it will impose an immense administrative burden in areas affected by high youth unemployment is certain. At the same time, the Commission recognises that there are already problems in general with the quality of traineeships. With many young coming out of education and work scarce, it is difficult to see this being implemented and having an

impact in practice. In addition, with the Youth Employment Initiative's focus on areas with high rates of unemployment, there is a fear that the Youth Guarantee will help subsidise work that is by no means sustainable in the longer term. There is also the risk that it may help to replace genuine employment of older or younger workers.

All this will further stretch overburdened public employment services, adding an extra layer of rules governing the unemployed, and dividing the services offered along age groups.

More recently, plans have been aired which would facilitate lending from the European Investment Bank to SMEs in a way that would "incentivise the hiring of young people" (European Commission, 2013). While the immediate effect on youth unemployment of such a proposal would depend on the amount of funding made available and the exact implementation mechanism, it is unlikely to have a large impact because of the lack of aggregate demand in areas affected by high youth unemployment. Subsidising youth entry into the labour market can be justified if there is a structural mismatch between the minimum wage (whether statutory or effectively negotiated) and the productivity of young people which prevents them from becoming employed. However, this should not be addressed by a temporary facility that is aimed chiefly at SMEs, and should ideally be tailored to a skill set (i.e. low-skilled workers) rather than depending on age. Again, there is a substantial risk that this will crowd out genuine jobs of older workers and simply shift the burden of unemployment.

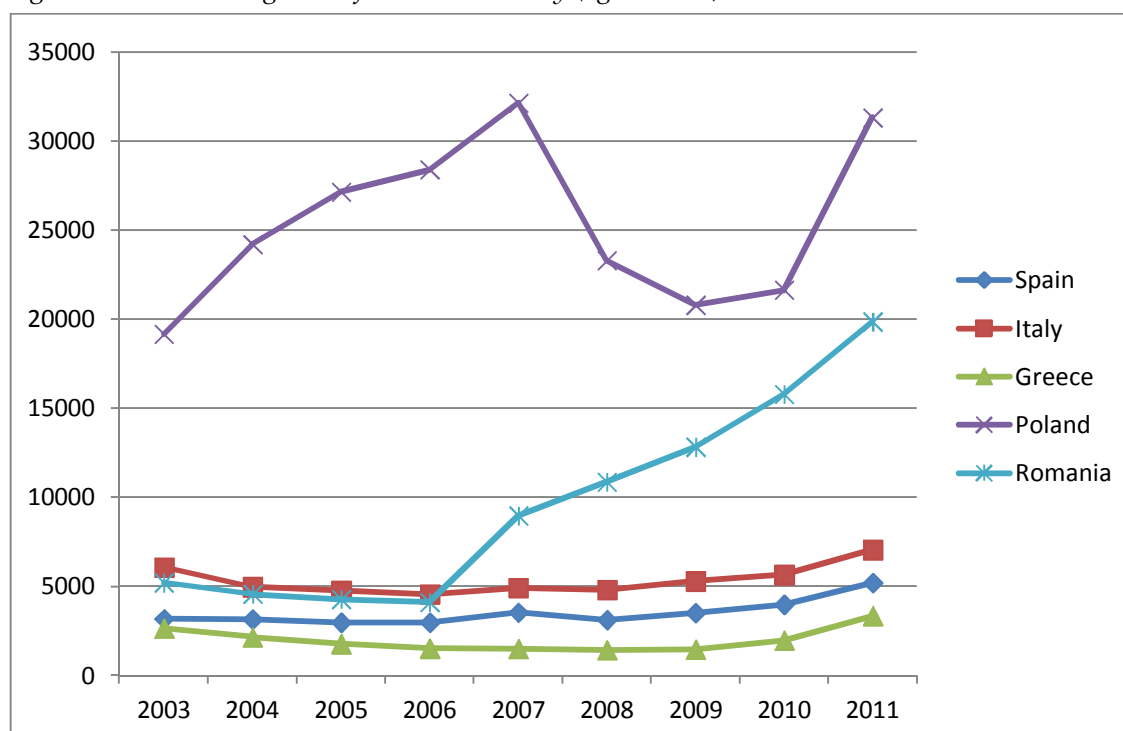
One of the biggest risks of the focus on youth unemployment, and the need to be seen to be doing something about it when there is not much that can be done, is that various temporary specialised subsidisation schemes will proliferate. These are costly, difficult to administer, create undesirable division between age groups and have little long-term rationale.

Labour mobility – promoting the internal market

While unemployment is high in southern Europe and the short-term macroeconomic outlook is poor, the opposite is currently the case in Germany. Unemployment is at its lowest level for decades and there are reports of labour shortages at the regional level in some occupations. *Furthermore, Germany is expected to grow at a fast enough pace next year that further jobs will be added.* This, combined with the demographic outlook for Germany where large cohorts are about to retire, offers a unique opportunity for mobile labour to seek opportunities in the north.

The German labour market is large and the national labour force will shrink considerably in the next ten years. That the potential exists for labour mobility is evidenced by the large numbers of Polish and Romanian people who have arrived in Germany in recent years (Figure 4). The influx of people from Spain, Portugal, Italy and Greece, on the other hand, is meagre in comparison; although this has grown considerably relative to the preceding two years, it was from a very low base (Table 1).

Figure 4. Youth immigration flows to Germany (aged 18-25)



Source: Eurostat.

Table 1. Recent immigration to Germany (all age groups)

	Average 2005-2009	2010	2011	2012	Difference: Average 2005-2009 and 2012	Change 2011/12
Greece	8,400	12,500	23,800	34,100	25,700	10,300 (↑43%)
Italy	19,000	24,500	30,200	42,200	23,200	12,000 (↑40%)
Spain	9,200	13,600	20,700	29,900	20,700	9,200 (↑45%)
Portugal	5,500	6,400	8,200	11,800	6,300	3,600 (↑43%)

Note: Figures represent immigration flows of non-Germans from partner countries.

Source: Bundesamt für Statistik Deutschland, 2013.

Both the federal and regional governments, together with German employers' organisations, are now trying to tap into the workforce potential in southern Europe (Barslund and Busse, 2013).

The Commission's approach to fostering this mobility has been too cautious. Stating the obvious that the decision to move "remains a personal decision for the individual concerned", it has chosen to promote its online tool for facilitating the matching of employers with employees, the EURES platform. EURES is the main tool available to the Commission and it therefore seems reasonable to "upgrade and modernise it" as set out in late 2012. However, it is lacking in ambition - exemplified by the fact that EURES apparently results in only 50,000 placements a year - and upgrade work will only begin in 2014.

Related to the EURES platform is the 'Your first EURES job' initiative (springing from the Youth Opportunities Initiative), which currently involves four countries: Denmark, Germany, Spain, and Italy. For employees, it provides support for matching and funds for interview trips and moving costs, while on the employer side there is support for recruitment and training costs. The scheme is limited to 18-30 year-olds. The initiative is currently being piloted and the target for 2012-13 is 5,000 placements. It is fair to say that it will not make a big impact.

The Commission's lack of ambition in this area is puzzling, since labour mobility and the internal labour market should be one of its children. The current situation calls for the Commission to use its considerable strength and know-how in bringing partners and stakeholders together to facilitate the necessary infrastructure to allow better matching across borders of workers and employers – over and above what is being done as part of EURES. The proposed revival of the Youth Employment Action Teams, which will be active in areas with very high youth unemployment, should be matched with selected employer organisations to explore mutual opportunities.

The question is then: where does this leave the sending countries? First, it has to be pointed out that individuals who find a job abroad are better off personally. Second, by moving they relieve the immediate strain on public resources in sending countries due to savings on health care expenditures, unemployment benefits and other social expenditures, and to reduced strain on retraining and educational facilities. There might also be a non-negligible value from an increased stream of remittances. Further down the road when southern economies pick up speed again, most are likely to come back – and they will have skills and experience, thereby contributing beyond what would have been possible had they stayed in the first place.

Conclusions

This Policy Brief carries four main messages.

First, the relationship between overall unemployment and that of youth is by no means special to this recession and the total number of youth unemployed is much smaller than generally assumed.

Second, the notion of a lost generation is misconceived. The empirical literature shows that there might indeed be a 'scarring' effect in the sense that a prolonged spell of unemployment leads to lower earnings later, but it applies across all cohorts. If there is any difference between youth and the others, it is that older workers are likely to suffer more.

The third message is that there really is no case for a specific focus on 'solving youth unemployment'. The proposals being churned out by the European institutions are likely to have little short-term impact and to the extent that they do, the impact might be detrimental to other cohorts. We fear that the need to be seen to 'be doing something about youth unemployment' will allow ever more expensive schemes to proliferate that will subsidise the employment of young workers at the expense of others, resulting in ever more distorted labour markets.

The final message is that encouraging labour mobility remains the one policy option which has some promise in the current situation of lopsided European labour markets, but it is approached too cautiously by the Commission. More should be done to facilitate labour mobility.

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