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Kiel Policy Brief

Youth Unemployment in Europe and the World: Causes, Consequences and Solutions

**Dennis Görlich, Ignat Stepanok,
and Fares Al-Hussami**

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Youth Unemployment in Europe and the World: Causes, Consequences, and Solutions

1. Introduction

The recent “Employment and Social Developments” report by the European Commission has drawn a bleak picture of the economic situation in Europe. Unemployment levels are on record-highs, household incomes have declined, and risks of poverty and social exclusion have risen, most notably in Southern and Eastern Europe. The group of young adults faces a particularly high risk, as long-term unemployment rates of this group have increased in many countries, and skill mismatch has become more severe.

However, youth unemployment is not only a European, but a global issue, with varying levels of severity across countries. The causes of youth unemployment also vary by country, and so do the solutions. Given the long-term risks of extended unemployment spells, the importance of tackling youth unemployment can hardly be overestimated. Youth are the potential and future of every country and governments with a long-term vision for welfare and development in their countries are concerned with the best ways to integrate the young people into the labour force. The topic has been receiving media attention and has been discussed in many business and policy forums.

In the European Union, youth unemployment currently ranks very high on the policy agenda. The European Commission has recently launched the “Youth Opportunities Initiative” in order to support unemployed youth. The aim is to supply funds for apprenticeship and entrepreneurship schemes, help with company placements and provide advice for young people with business ideas.

This Kiel Policy Brief aims at introducing the reader to the topic of youth unemployment. After defining youth unemployment, it provides an overview on the extent of youth unemployment around the world, discusses some of the main reasons for, and consequences of youth unemployment, and concludes with a few solutions for how to reduce it.

2. Definition of Youth Unemployment

The United Nations define youth as the age group between 15 and 24. Variation in the definitions of individual countries’ official statistics makes cross-country comparisons difficult.¹ In some analyses, the youth are further divided into teenagers (15–19 years old)

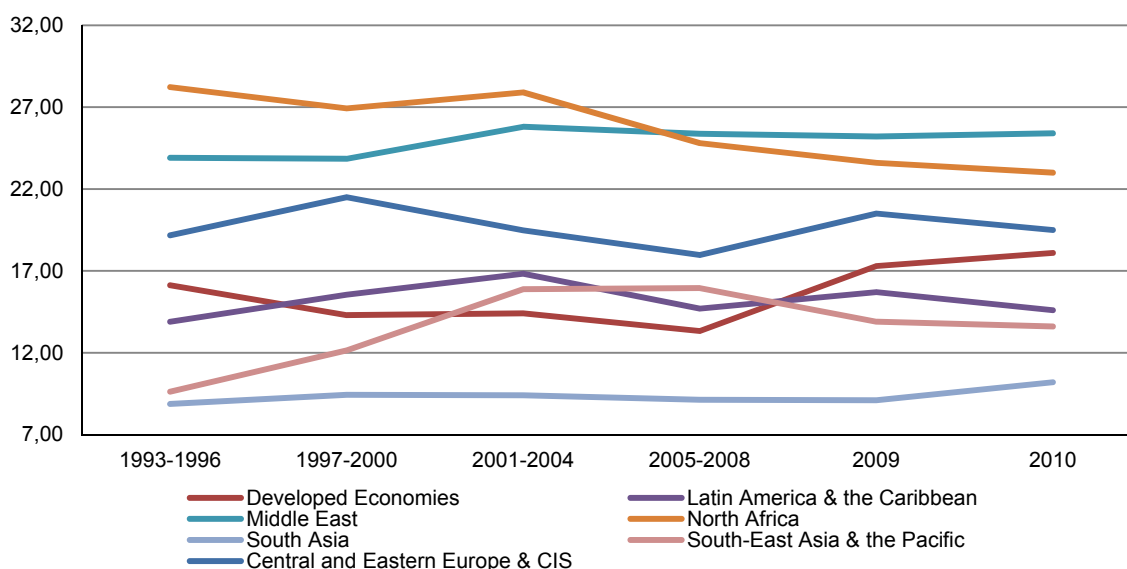
¹ In particular, the lower age limit for young people is usually determined by the minimum age for leaving school (where this exists). As a consequence, the lower age bound often varies between 10 and 16 years across different countries (ILO 2011)

and young adults (20–24 years old). Some authors argue that the unemployment numbers for these two groups and the challenges they face vary significantly and would thus call for separate approaches for alleviating unemployment.

An individual is typically considered unemployed when he or she has not worked for a specific period of time but would like to and is, hence, actively searching for work. Yet, the definition of unemployment can also vary from country to country. In some countries, students who are actively looking for a job are counted as part of the work force while, in others, they are not. The number of inactive youth, i.e. those not actively searching for work and not being in the labour force or in education can also exhibit quite a variation across countries.² Such data of the non-employed, which comprises of both unemployed and inactive individuals, can be more meaningful as it gives a clearer idea of the real magnitude of the problem. It is, however, less viable due to differences in definitions and problems with the availability.

There is a significant variation in youth unemployment rates across countries. The figure below shows the percentage of unemployed youth as a fraction of all youth in several regions of the world. The numbers show large differences between regions with the Middle East and North Africa with consistently higher rates.

Figure 1:
Youth unemployment rate since the 1990s



Note: Youth unemployment rate is the unemployment rate among young workers aged 15–25.

Source: ILO, Trends Econometric Models, taken from various issues of the ILO Global Employment Trends.

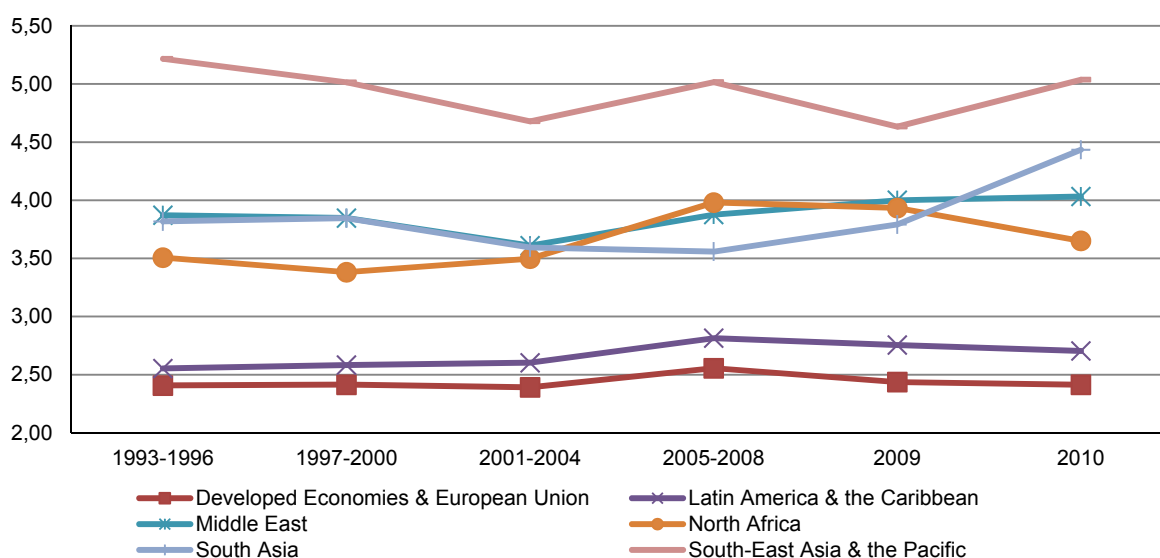
² They are also referred to as discouraged workers. Within the OECD countries, countries such as Ireland, Austria, Denmark, United States and Germany exhibit very low percentages of young discouraged workers (less than 0.1 percent of the labor force between 2000 and 2008) while Hungary and Sweden display considerably higher ratios of more than five percent over the same period.

The unemployed often belong to particular groups: ethnic minorities, high school dropouts, residents of poorer areas (Freeman, Wise 1982). As the socio-economic situation of these groups is problematic in general, this underlines the importance of tackling youth unemployment.

The numbers of figure 1 do not only expose the large regional differences but also the fact that youth unemployment has been consistently very high. The next figure shows how it compares to adult unemployment in the same regions and for the same periods.

The striking fact is that youth unemployment is considerably higher than unemployment among adults and has been so throughout the last two decades. The biggest relative difference is in South-East Asia and the Pacific, while developed economies and the European Union seem to have youth unemployment on average about two to two and a half times higher than adult unemployment.

Figure 2:
Ratio of youth unemployment over adult unemployment rate



Source: ILO, Trends Econometric Models, taken from various issues of the ILO Global Employment Trends.

3. Causes

There are a number of causes of youth unemployment on many of which there is a fair amount of consensus. The most significant is poor macroeconomic performance. Lack of growth affects everyone in the economy and some groups are particularly hard-hit. In fact, youth are more affected because youth unemployment tends to be super-cyclical. It fluctuates stronger than adult unemployment (Ryan 2001).

The factors contributing to this higher cyclical volatility are several: young workers usually have lower job protection. In addition, they are most likely to have gained less job-specific

experience; the companies have invested less in training them and therefore lose less when laying them off relative to an adult experienced worker. Also, severance pay tends to increase with tenure, making it less costly to fire a young worker (cf. Pagés, Montenegro 2007).

Youth may also be more likely than adult workers to resign voluntarily because they are more likely to be willing to explore different opportunities before they settle. This also holds in times of economic downturn (O'Higgins 2001: 40). In addition, they face a lower opportunity cost for resigning, are less likely to have dependents that they need to support, and turning to higher education is a more natural and viable option for them than for adults.

Youth also face higher barriers to entry into the labour market due to their lack of experience. Shorter credit history and lack of access to business networks makes it more difficult for them to become successful entrepreneurs (Coenjaerts et al. 2009: 6). Moreover, in a recession, before starting to lay people off, firms first stop hiring. Given that young workers are represented disproportionately within the pool of searching individuals, they will be disproportionately affected by such a slowdown in hiring (O'Higgins 2001).

Another important contributor to higher youth unemployment is a rising youth population. This is particularly relevant in the Middle East and Northern Africa (MENA) and in South and Sub-Saharan Africa, where limited labour demand prevents many youth from finding a proper job (cf. Biavaschi et al. 2012). It can be effectively counterbalanced by a steady economic growth (O'Higgins 2001). In the ageing societies of developed nations, we rather observe a shrinking youth population. Some contributors have suggested that this will help the problem of youth unemployment to solve itself. Yet, youth outcomes have deteriorated despite an ageing population (Ryan 2001)

Employment protection legislation (EPL) also affects youth unemployment. During the 1980s, European economies suffered from high rates of unemployment. Policy makers consequently introduced a wide array of reforms. A common measure has been to ease EPL for temporary (fixed-term) contracts, while leaving EPL for permanent contracts unchanged. These reforms have contributed to raising employment during upturns, but many of the new jobs have been temporary jobs (Bentolila, Boeri, Cahuc 2010). These temporary jobs are mainly held by youth (e.g. Ryan 2001; OECD 2004). During recessions, many of the temporary jobs were the first to be shed, hence creating youth unemployment (e.g. Boeri 2009). Indeed, during the recent great recession, youth have been hit particularly strongly and temporary contracts have become the dominant contract type for newly established contracts of young people (O'Higgins 2012). The problem of segmented labour markets is particularly severe in Mediterranean countries of Europe, most notably Spain.

Some authors argue that employment protection legislation, and also minimum wages, do not play any significant role for the level of youth unemployment (O'Higgins 2001; Freeman 2005; Cazes, Nesporova 2003; Godfrey 2003). Others claim that the effects are unclear (Coenjaerts et al. 2009: 7).

Finally, the mismatch between the demand and supply of skills possessed by young workers has been mentioned to contribute to higher youth unemployment rates (Coenjaerts

et al. 2009). Manacorda and Petrongolo (1999) show that there is a relationship between skills mismatch and total unemployment across OECD countries. The skill mismatch issue is particularly important in the developing world. For example, firm surveys in the MENA region show that entrepreneurs regularly cite the lack of skills as an important constraint to hiring, in some cases suggesting that it outweighs concerns with labour market regulations (Assaf, Benhassine 2003). Skill mismatch, combined with a growing share of youth in the labour force in MENA, has created a situation in which too many young people have a hard time finding jobs (Assaad, Roudi-Fahimi 2007: 6). Besides the MENA region, skill mismatch also characterizes the youth labour markets in Latin America, Central and Eastern Europe, and in parts of Asia.

4. Consequences

For various reasons, youth unemployment rates are higher than adult unemployment rates. However, it remains disputed whether this is problematic as such. In fact, unemployment may be a smaller problem for the youth because it typically is of shorter duration (O'Higgins 2007).³ Moreover, youth may simply switch jobs more often because they are seeking for the right job, so that the higher unemployment rates which we observe are mainly search unemployment and, thus, not particularly harmful.

Yet, unemployment early in life may have persistent negative consequences for the persons' subsequent career, as it may impair their productive potential and employment opportunities (O'Higgins 2007; Ryan 2001). Indeed, there appear to be scarring effects attached to early unemployment spells, which significantly reduce subsequent wages and increase the probability of future unemployment spells (Nordström Skans 2005; Arulampalam 2001). Several reasons for such scarring effects have been suggested:

1. Patterns of behaviour established at an early stage tend to persist. Thus, certain behaviour "inherited" from unemployment spells may make these workers less productive (e.g. O'Higgins 2007).
2. Skills and motivation may decay during the unemployment spell (Ryan 2001). Skills may become obsolete due to non-use, or because organizational or technological developments make formerly acquired skills less valuable (De Grip, van Loo 2002).
3. Employers may take unemployment spells as signalling device, suggesting to them that the person is potentially less productive (e.g. Gibbons, Katz 1991).⁴

³ Note that some authors find that unemployment spells are only little shorter for youth than for adults (cf. Ryan 2001)

⁴ Cockx and Picchio (2011) find that negative duration dependence in the job finding rate is induced only by negative signaling but not by human capital depreciation of the young.

Apart from scarring effects, youth unemployment has been found to be associated with drug use and crime (O'Higgins 2007; Fougère, Kramarz, Pouget 2009). This is particularly severe as youth unemployment is typically concentrated among groups which have additional social problems (cf. Freeman, Wise 1982).

To the extent that partial reforms of EPL have pushed young people into temporary jobs, further costs are incurred by youth.

- Temporary jobs are the most fragile and least protected, paying lower wages while also giving lower job security. As a result, access to credit and mortgages is often limited for these workers (Boeri 2009).
- Firms are often reluctant to transform temporary jobs into permanent ones (Bentolila, Boeri, Cahuc 2010).
- Temporary workers often receive less training, hence harming their long-term employment prospects.
- Temporary workers are most strongly affected by globalization. It has been shown that labour market adjustment to offshoring occurs mainly via temporary workers. In particular, offshoring is associated with lower wages and higher unemployment probability of temporary, and hence, young workers (Görg, Görlich 2011).

5. Solutions

A large number of solutions to tackle youth unemployment are on the table. Given that the youth unemployment problem is strongly correlated with general unemployment, the most important solution is to improve the macroeconomic environment in order to achieve a growth of salaried employment (see also Coenjaerts et al. 2009). Policies may target sectors with high potential for employment growth, to youth-friendly sectors such as tourism, ICT, basic and social services, or environmental management. It is argued that youth employment interventions must be linked to the broader development frameworks of countries (Coenjaerts et al. 2009).

Unemployed youth in rural areas of developing countries may benefit mostly from reforms of the agricultural sector moving it away from subsistence farming and towards commercial use (Coenjaerts et al. 2009). Moreover, it is important to provide jobs in the formal sector, as a high degree of informality in these countries hinders young people to find continuous employment.

The internet offers numerous possibilities for individuals to become part of the global value chain. Tasks, that can be transmitted electronically, can be performed anywhere in the world. The youth, who are typically open to new technologies can offer their services on central electronic platforms and thereby reach a much larger market. This would open up

new opportunities for both work and training globally and may have a particularly strong effect in remote, rural parts of the world.

Further, wage subsidies and reductions in pay-roll taxes have been suggested. Their goal would be to increase firms' incentives to hire young workers in the light of worries about the youths' lack of experience and potential volatility of their employment relationship (Coenjaerts et al. 2009).

It has also been discussed whether youth are harmed by minimum wages. Evidence is mixed (OECD 2006; Card, Krueger 1995). O'Higgins (2007) claims that minimum wages do not damage employment prospects of youth, whereas Ryan (2001) notes that there are adverse effects of minimum wages on youth employment, even though they are modest. Neumark and Wascher (2004) show that youth disemployment effects of minimum wages are stronger in the countries with the least regulated labour markets. This suggests that there is a need of coordinating the different policies by evaluating their impact on youth in the light of the overall labour market institutional setting.

Active labour market policies have also widely been suggested. Examples are entrepreneurship training (Coenjaerts et al. 2009), career guidance (Coenjaerts et al. 2009), or job search assistance programs (OECD 2006). In general, however, it appears that training and employment programs have a small impact on employment prospects as their effectiveness largely depends on the state of economy (O'Higgins 2007; Ryan 2001). Effectiveness can be improved somewhat when participation in the program is voluntary. Yet, the OECD (2006) advises to make participation in programs compulsory for youth after searching for a job for six months or more. They argue that, while making programs more costly and less effective, compulsory participation is the only way to reach those who are most at risk of social exclusion.

Indeed, the targeting of youth employment policies is very important because youth unemployment is not spread evenly across the youth population (O'Higgins 2007). It is mostly a problem of minorities. One also needs to distinguish between teenagers and young adults (OECD 2006). Teenagers need assistance in remaining in (or returning to) school, whereas young adults need assistance in acquiring work experience.

The implementation of a dual system linking education and training has also received a lot of attention due to its assumed potential to alleviate youth unemployment by improving school-to-work transition (OECD 2006). A dual system is characterized by a strong linkage between work-based training and apprenticeship, and school-based education. Examples for successful dual systems are those in Germany and Japan. A dual system stands in contrast to a purely school-based vocational education. In developing countries, it is important to design the dual system around the informal market and thereby assure that skills, which were obtained informally, are recognized and certified (Coenjaerts et al. 2009).

Establishing a dual system can be difficult, however. It requires powerful employer associations and involvement of all social partners (OECD 2006). Moreover, there is a constant struggle to ensure that the type and content of training meets the ever-changing labour market demands (OECD 2006). Indeed, there may be problems arising against the background

of the changing organization of work: we observe strong trends towards multitasking (in contrast to task specialization) implying an on-going blurring of occupational borders (Görlich, Snower 2010). In other words, while occupations used to be connected to specific tasks, they nowadays entail a much broader span of tasks. Hence, occupations nowadays require more versatility from workers.

Rigid apprenticeship programmes may not pay sufficient attention to such versatile skills as they typically focus on teaching specific occupational skills. This presumption is supported by evidence that the initial labour market advantage of vocational relative to general training fades with age (Hanushek, Woessmann, Zhang 2011). One reason for rigid training curricula may be the need to formally test the apprentices' skills in order to award them their occupational certification, which they require to find and carry out their jobs later on. Yet, if occupational borders are blurring and occupations become broader in terms of the tasks they entail, youth may need different and much broader skills than they used to in the past. Rigid occupational certification systems may prevent them from acquiring such broader skills as the focus of their training remains on issues needed for certification and curricula remain inflexible.

Employment protection legislation may also need further reform as it is currently rather harmful to the employment prospects of youth. In particular, EPL for permanent contracts, which is currently rather rigid, needs to be softened. Protection of permanent contracts is stepwise, i.e. it is only activated after a fixed amount of tenure acquired by the worker. Bentolila, Boeri and Cahuc (2010) and Boeri (2009) suggest introducing "graded job security" where employment protection increases smoothly as workers acquire tenure. Such a policy would avoid the gap between jobs with different status (permanent vs. temporary), while preserving flexibility. This policy measure is especially applicable in countries with strongly segmented labour markets, such as, for example, Spain.

In general, any employment policies targeted at youth need to take possible crowding-out effects for other age groups into account. The implementation of such policies thus requires a careful balancing with other potential goals.

Reducing unemployment is a challenging task. Tackling youth unemployment without doing it at the expense of other age groups can be even more difficult. However, solutions are abundant: some are more specific and applicable only to particular environments, others more general and flexible; some are more disputable, others more widely accepted. As the causes of youth unemployment differ across countries, so do the potential solutions.

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