

Generation Indebted Jobless

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A European Labor Market with Full
Employment, More Income Security and
Less Income Inequality in 2020

Bonn, IZA/VEF Workshop
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Outline

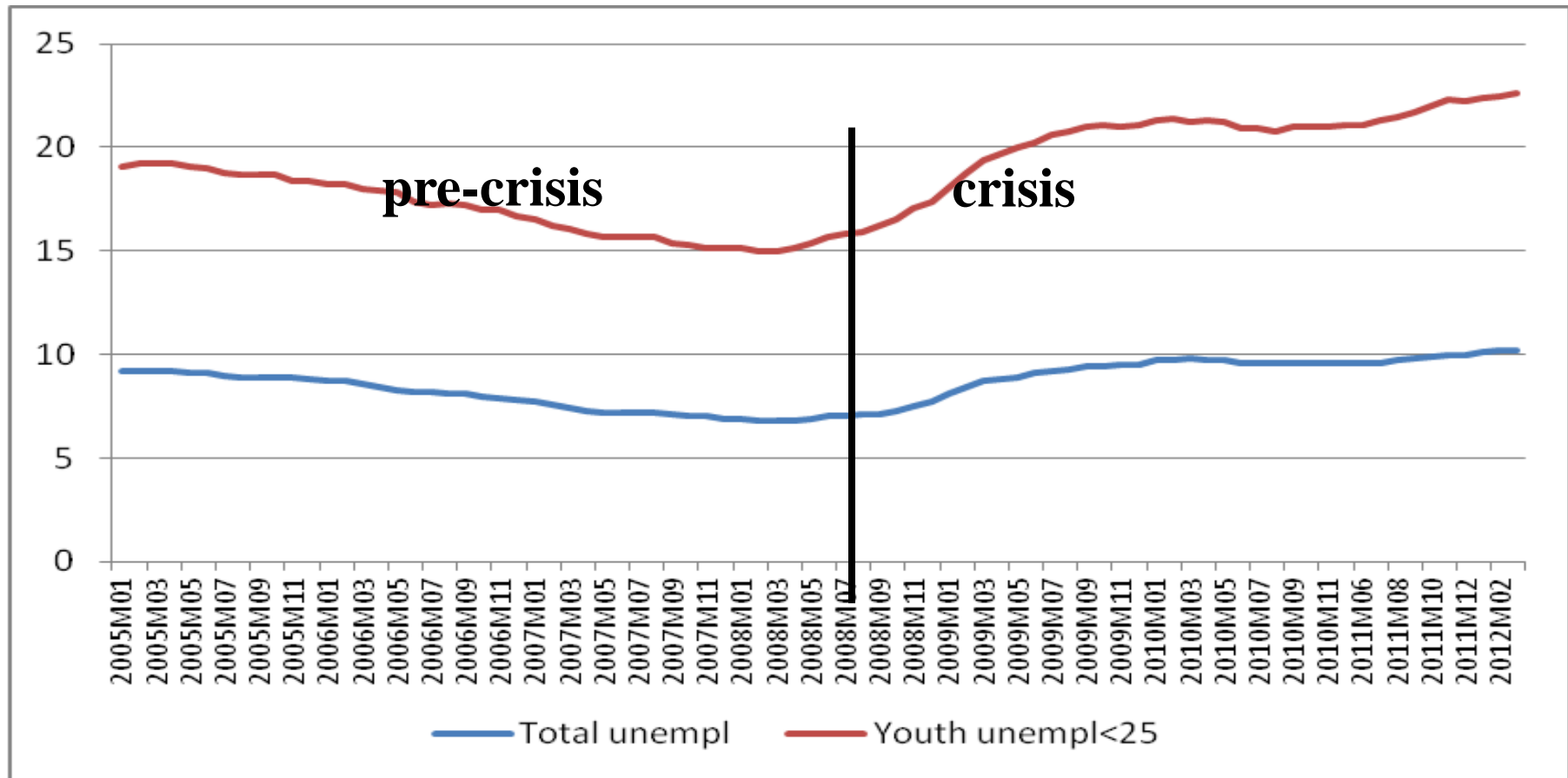
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- A global rise but not uniform across the board
- Should we worry about it?
- The key mechanisms: cyclical vs. Structural factors
- Can we do anything about it?

Youth unemployment increased dramatically since 2008

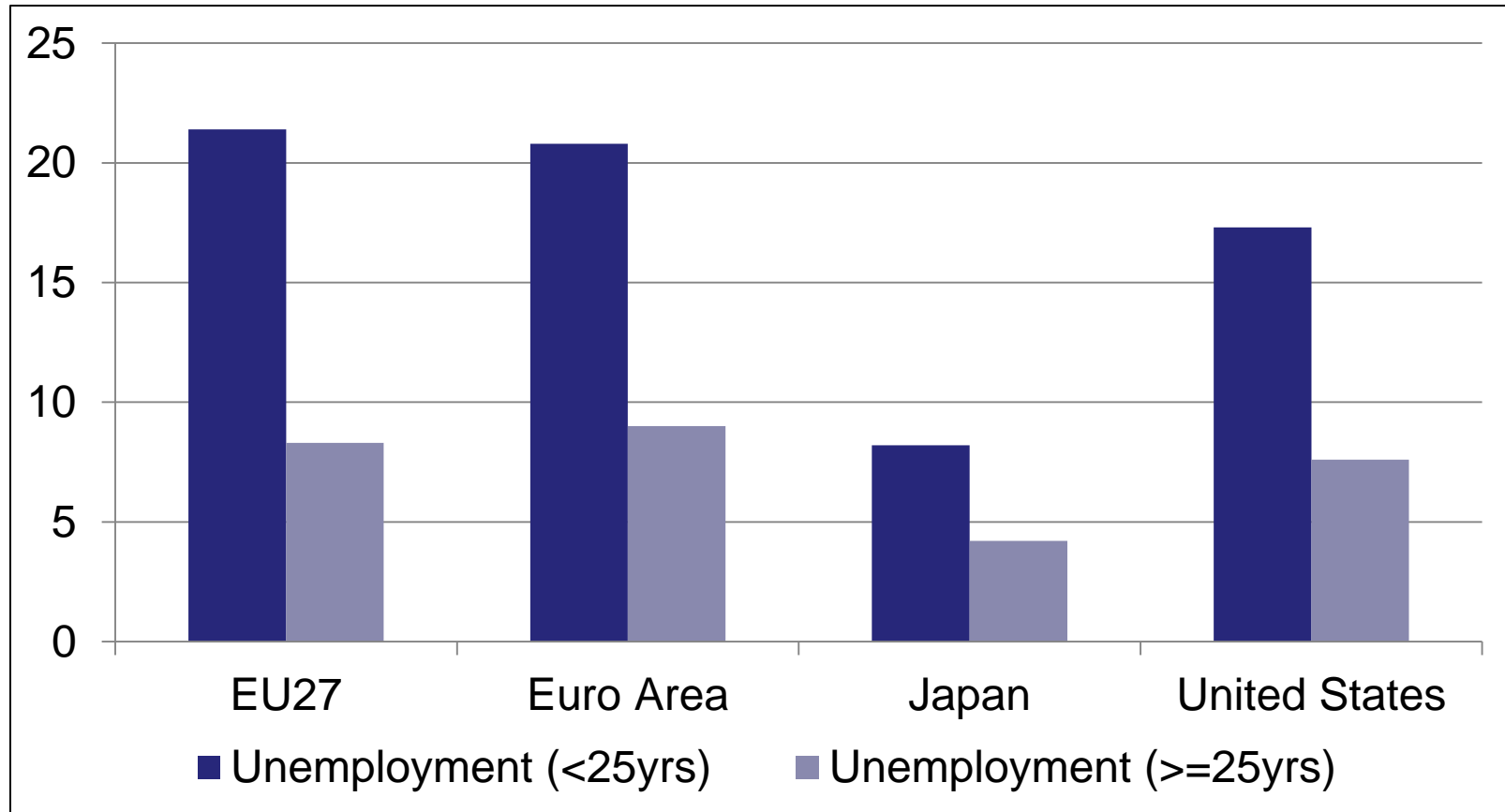
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after marked decline between 2005-2008



Youth Unemployment Across Macro Areas, 2011

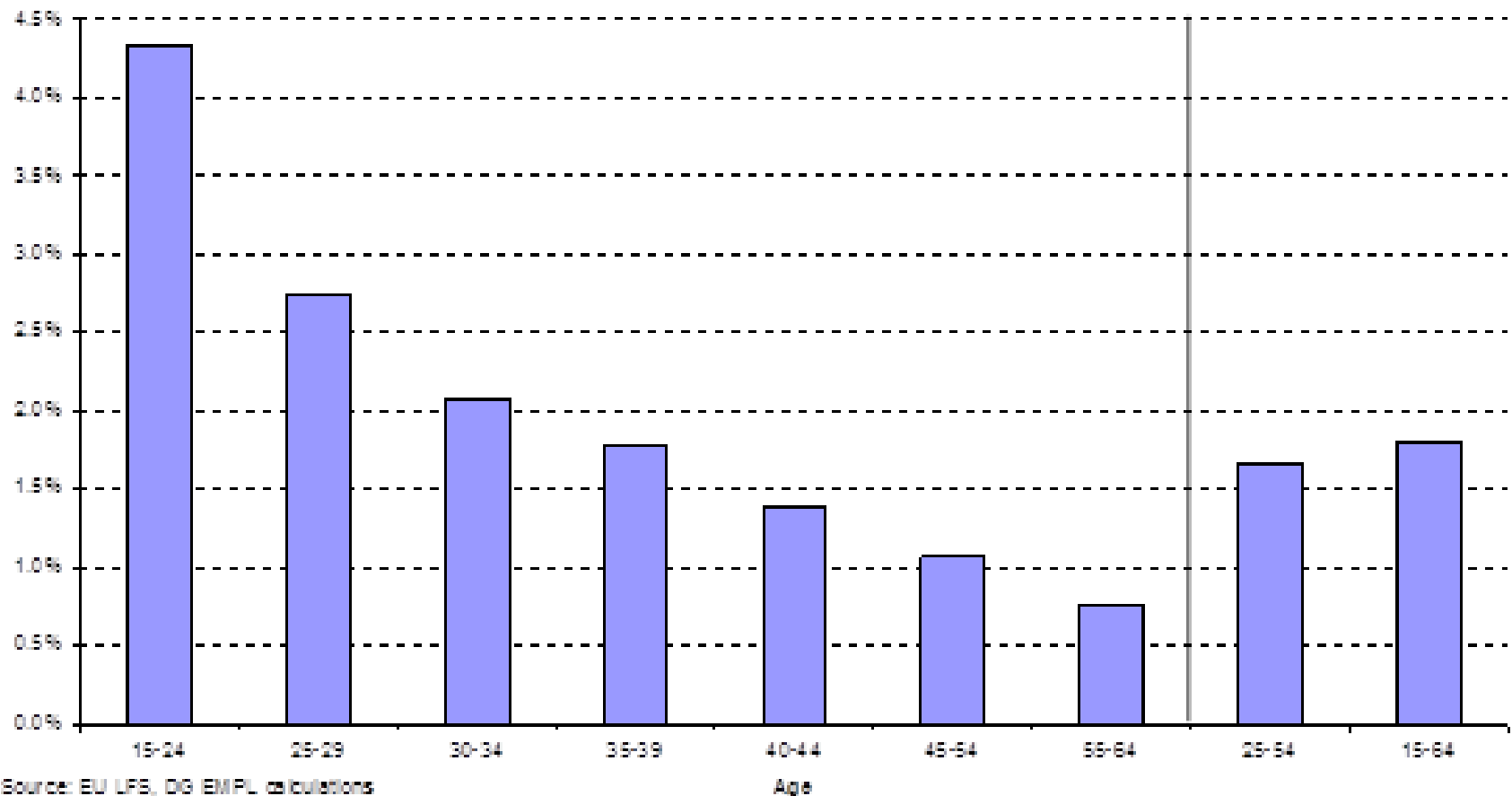
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Source: EUROSTAT

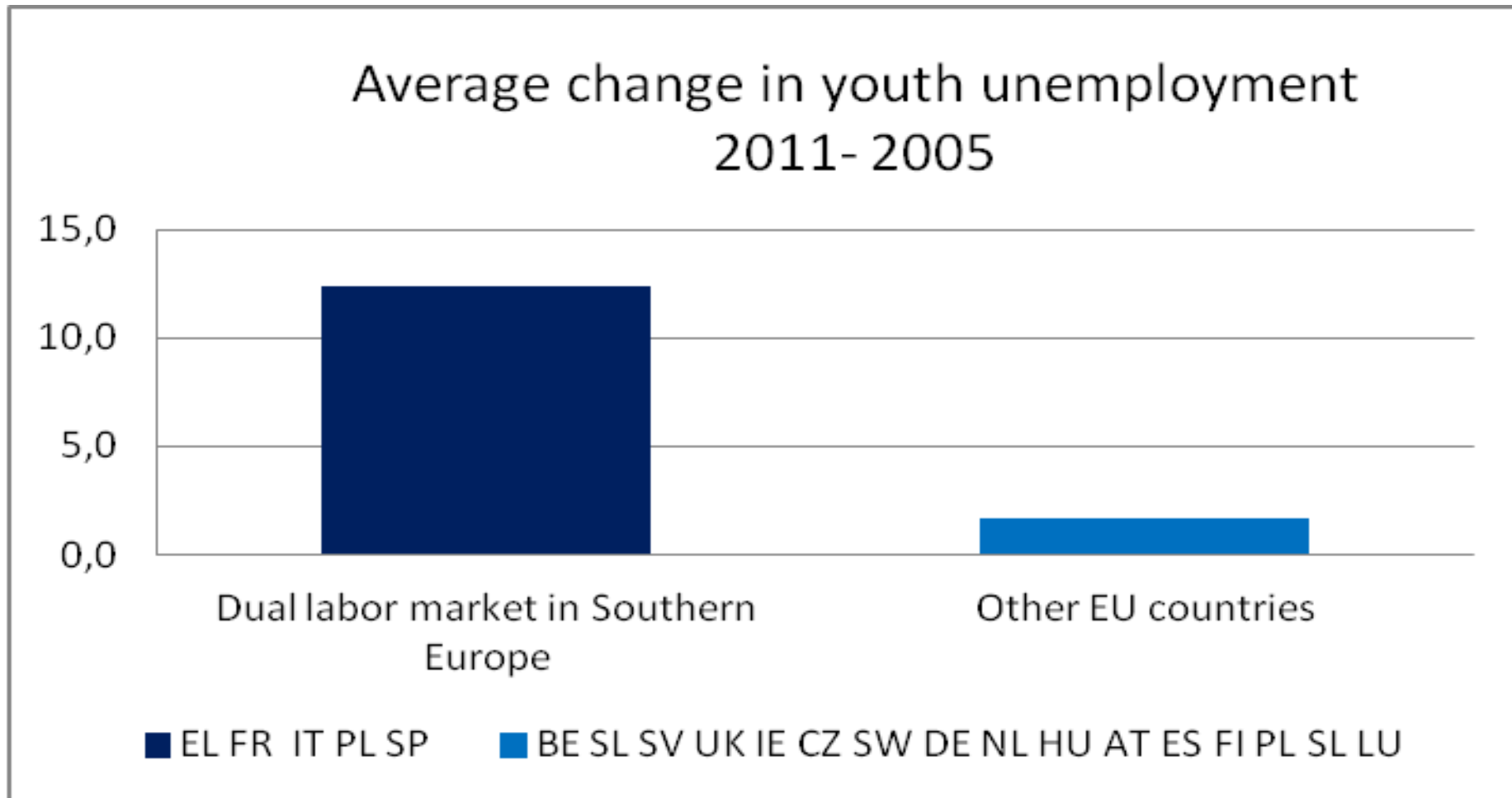
Increase in unemployment concentrated among the youth... f R D B

UR differences after and before the crisis (2009-2007) in the EU by age group



.... and in Southern Europe

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Source: EUROSTAT

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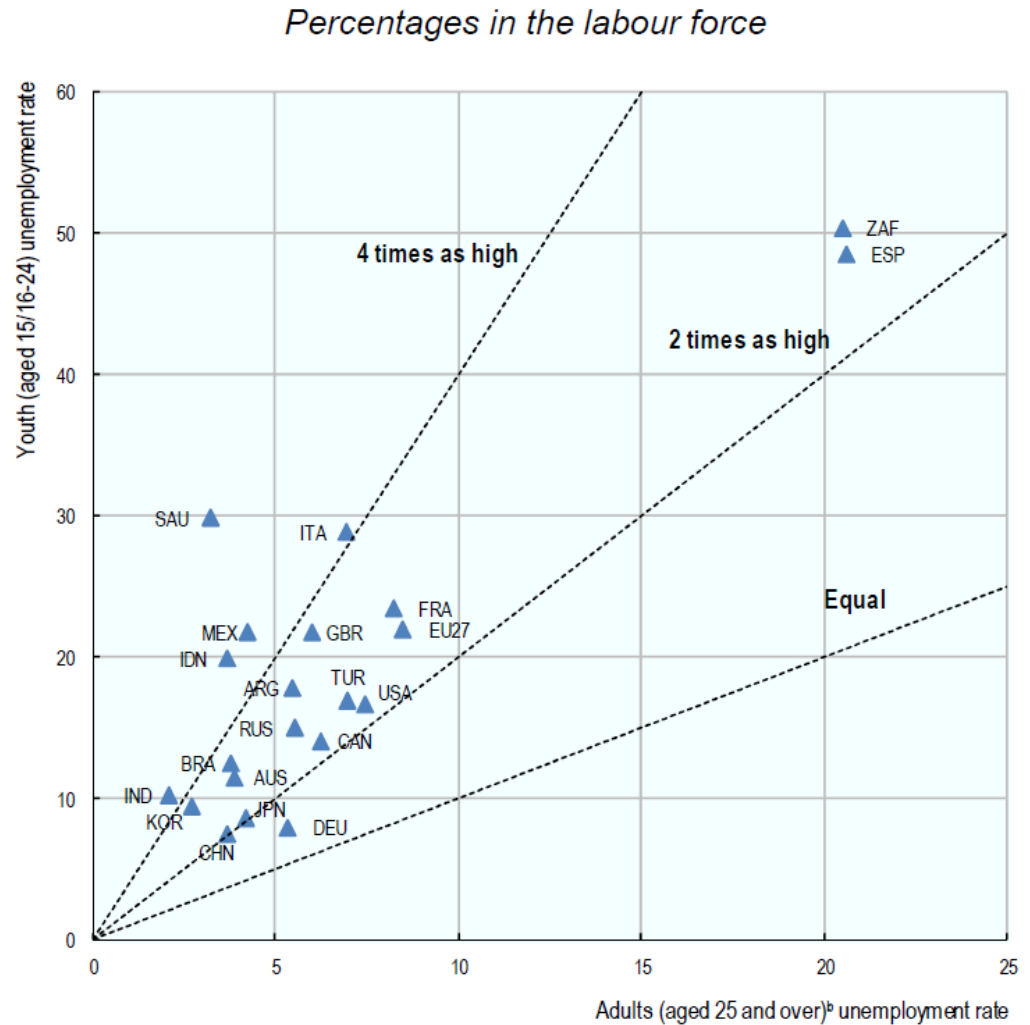
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Youth to adult unemployment

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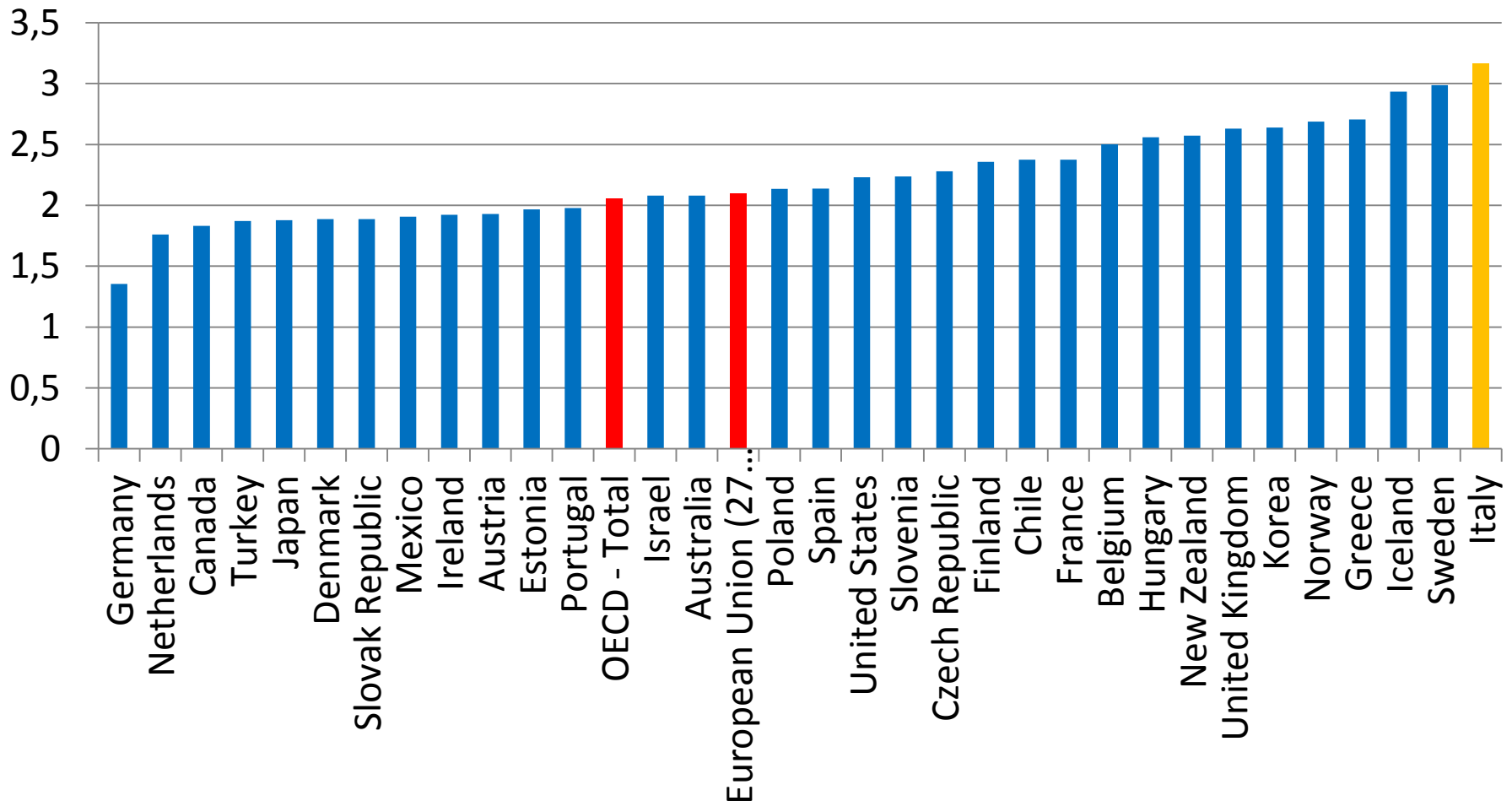
**Youth and adult
unemployment
rates,
2011 Q4a**



Ranking of countries

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ratio of youth to total unemployment. 2005-07

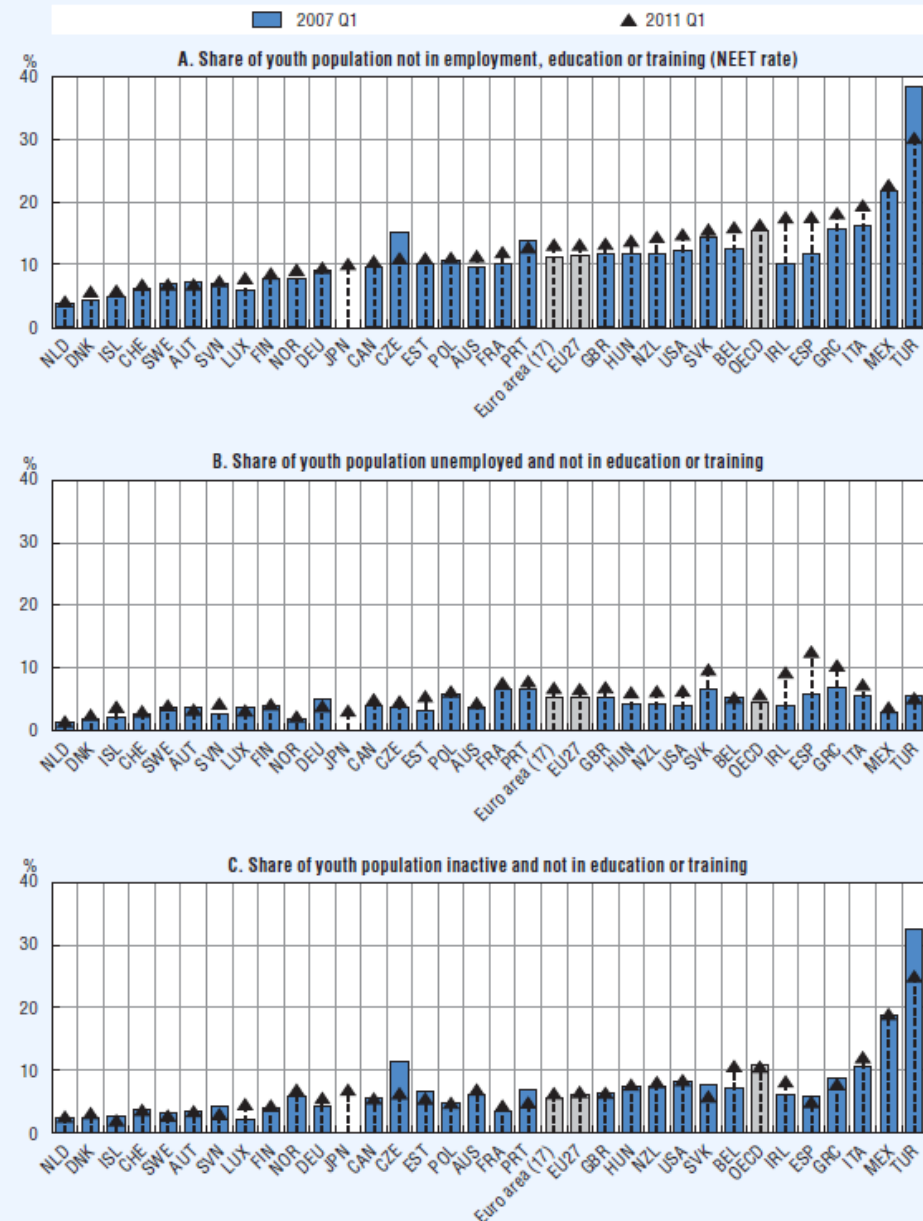


A NEET generation

Not in
Employment
Education or
Training

NEET rates among youth in OECD countries

Percentage of population aged 15-24, ^a 2007 Q1-2011 Q1^b



Note: Countries are shown in ascending order of the NEET rate in 2011 Q1.

a) OECD, EU27 and euro area (17) are weighted averages. OECD includes 30 countries (excluding Chile, Israel, Japan and Korea).

b) 2007 Q2-2011 Q2 for Australia, 2007 Q2-2011 Q1 for Switzerland, and 2011 Q1 for Japan.

Source: OECD estimates based on national labour force surveys.

Some worldwide figures

- In the EU27 increased by 30% since 2007. Currently 7.5 million under 25 are NEET
- About 300 million youth in this condition globally, like US population
- Youth unemployment rate in the EU27 at 23.5% in the EU27, with peaks at 70 per cent in some regions, but also 5 per cent in some.

Should we worry about it?

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- Whereas some unemployment is necessary, long duration unemployment can be very harmful
- It carries implications for wages and unemployment incidence in later life (the scarring effect of unemployment)
- It causes a lot of misery (from “happiness” studies)

Evidence of « scarring » effects for these groups

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Sizeable long-term effects of **unemployment** at labour market entry on **annual earnings** in France, Germany, Italy, Spain, the UK and the US:

UK a 1 % point increase in the unemployment rate at entry reduces earnings by almost 8%. This effect declines over time to just 2% ten years after entry and disappears thereafter. More persistent effect for highly educated.

US, the contemporaneous decline in earnings 2-3% and it dissipates within ten years of labour market entry. More persistent effect for the low-educated

France and **Spain**, negative contemporaneous effect of 2-3% on earnings; this effect persists up to 15 years after labour market entry.

More (scaring) on scarring

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- *Ellwood* (1982): poor start induces lower lifetime wages and lower employment opportunities
- *Kletzer and Fairlie* (1999): entry long-term unemployment implies wage losses over the lifetime of 8 per cent for men and 13 per cent for women (US)
- *Arulampalam* (2001): increase in risk of new job losses (Britain)
- *Gregg and Tominey* (2005): lifetime wage losses even larger (13 to 21 per cent)
- *Mroz e Savage* (2006): unemployment at 22 implies earning 30 per cent lower at 25. At age 30-32 below -2-3 per cent
- *Von Wachter and Heisz* (2006): long term career effects on those graduating in a recession
- *Bell and Blanchflower* (2009) *von Wachter* (2009): health effect even 20 years after

Figure 5A: Annual Earnings Losses Before/After Job Displacement in \$1000
 Averages for Displacements in NBER Recessions and Expansions
 Men with At Least 3 Years of Job Tenure Displaced at Firms Size 50+
 Displaced as Firm has Lasting 30% Employment Drop Over 2 Years

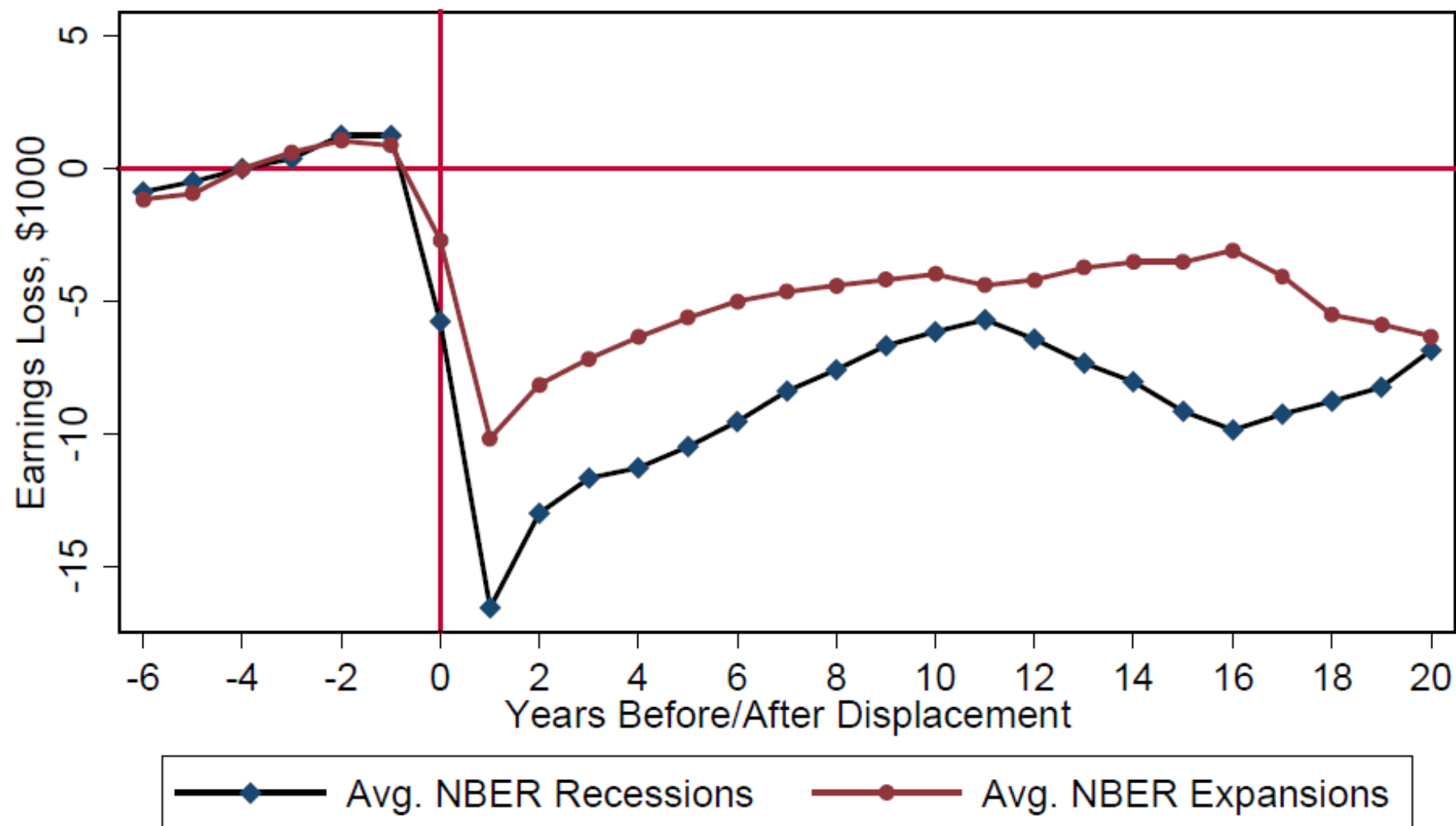
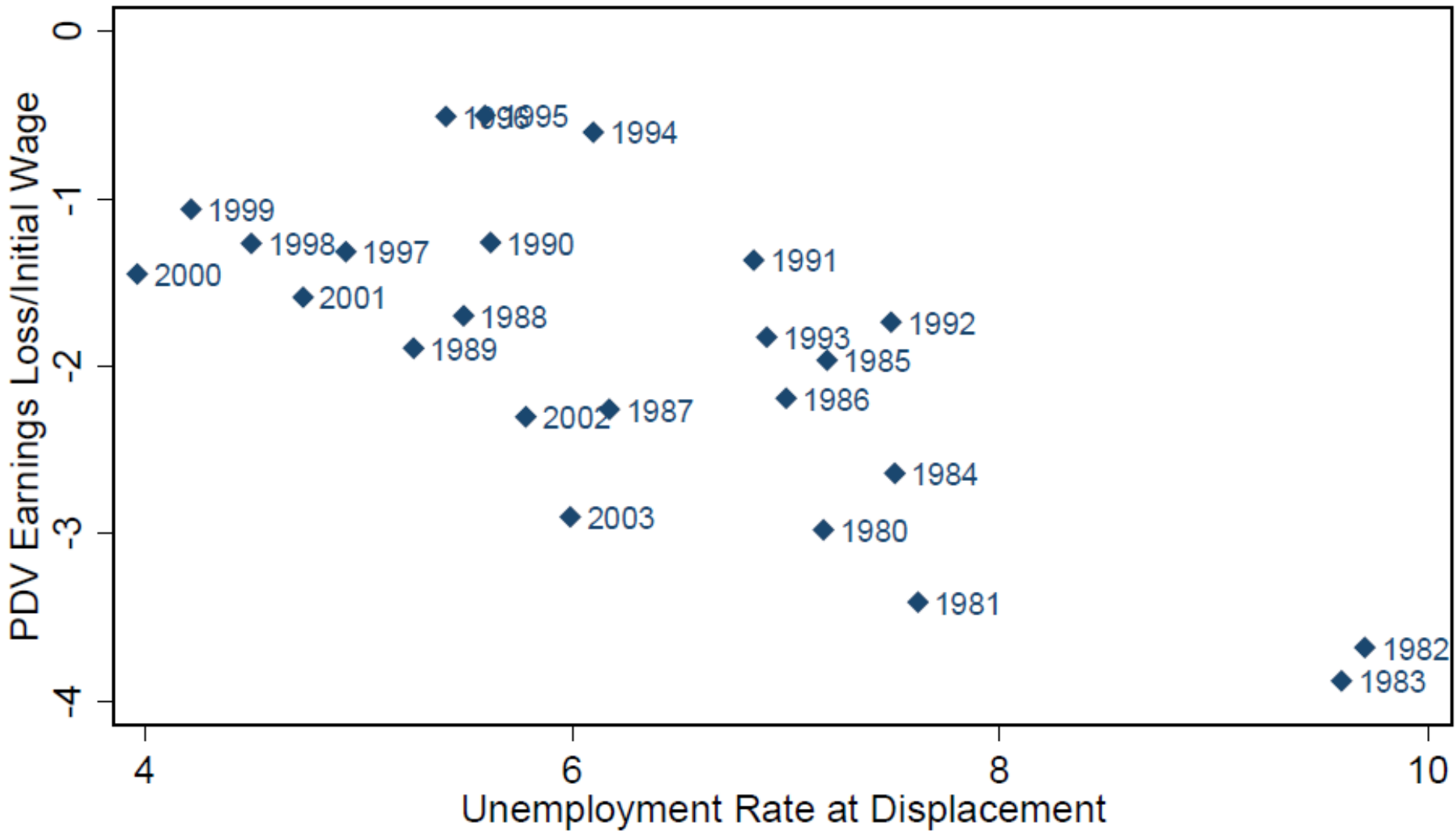


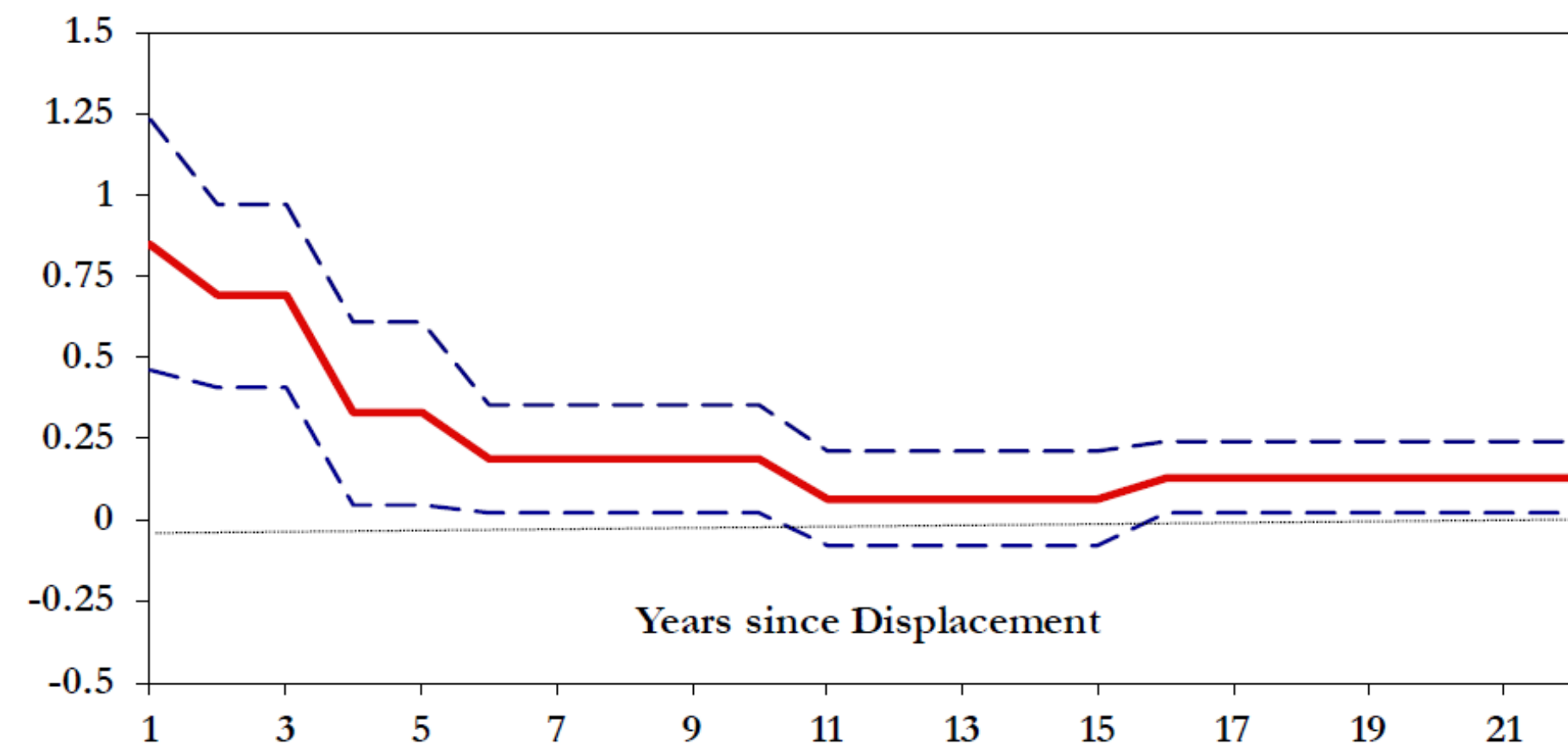
Figure 7: Present Discounted Value of Earnings Losses By Year of Displ.
Expressed as Multiple of Annual Earnings Before Displacement
Men with At Least 3 Years of Job Tenure Displaced at Firms Size 50+
Displaced as Firm has Lasting 30% Employment Drop Over 2 Years



Source: S. Davis and von Wachter, Brookings Papers on Economic Activity, 2011

Figure II: The Effect of Displacement on Log-Odds of Death by Years Since Displacement

Panel A: Effect by Years Since Displacement for Workers Born 1930-1959
(Including Two Standard Error Bands)



Notes: Solid line represents coefficients of log-odds model of mortality on years since displacement and basic other control variables. These are the main effects corresponding to Column 1, Table 4. Dashed lines represent two-standard errors bands.

Source: D. Sullivan and von Wachter, Quarterly Journal of Economics, 2009

Outline

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- A global rise but not uniform across the board
- Should we worry about it?
- The key mechanisms: cyclical vs. Structural factors
- Can we do anything about it?

Why is unemployment so much concentrated among young people?

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- The physiology of unemployment in a recession
- Structural problems: contractual dualism and skill mismatch in the transition from school to work

A normal (imperfect) labor market

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- Search theory: labor market with frictions, particularly suited for youngsters (job shopping)
- Youngsters need to collect more information about jobs and experiment
- Employers are less informed about them
- More turnover among young people (higher hirings and separations)

During a Recession I

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- **Hiring side.** A hiring freeze. The least costly way to downsize. Even if hiring declines proportionally at all ages, it would hit more the youngsters because starting from higher levels of hiring.
- Moreover, school leavers can only enter the labor force. Expand education during recessions!

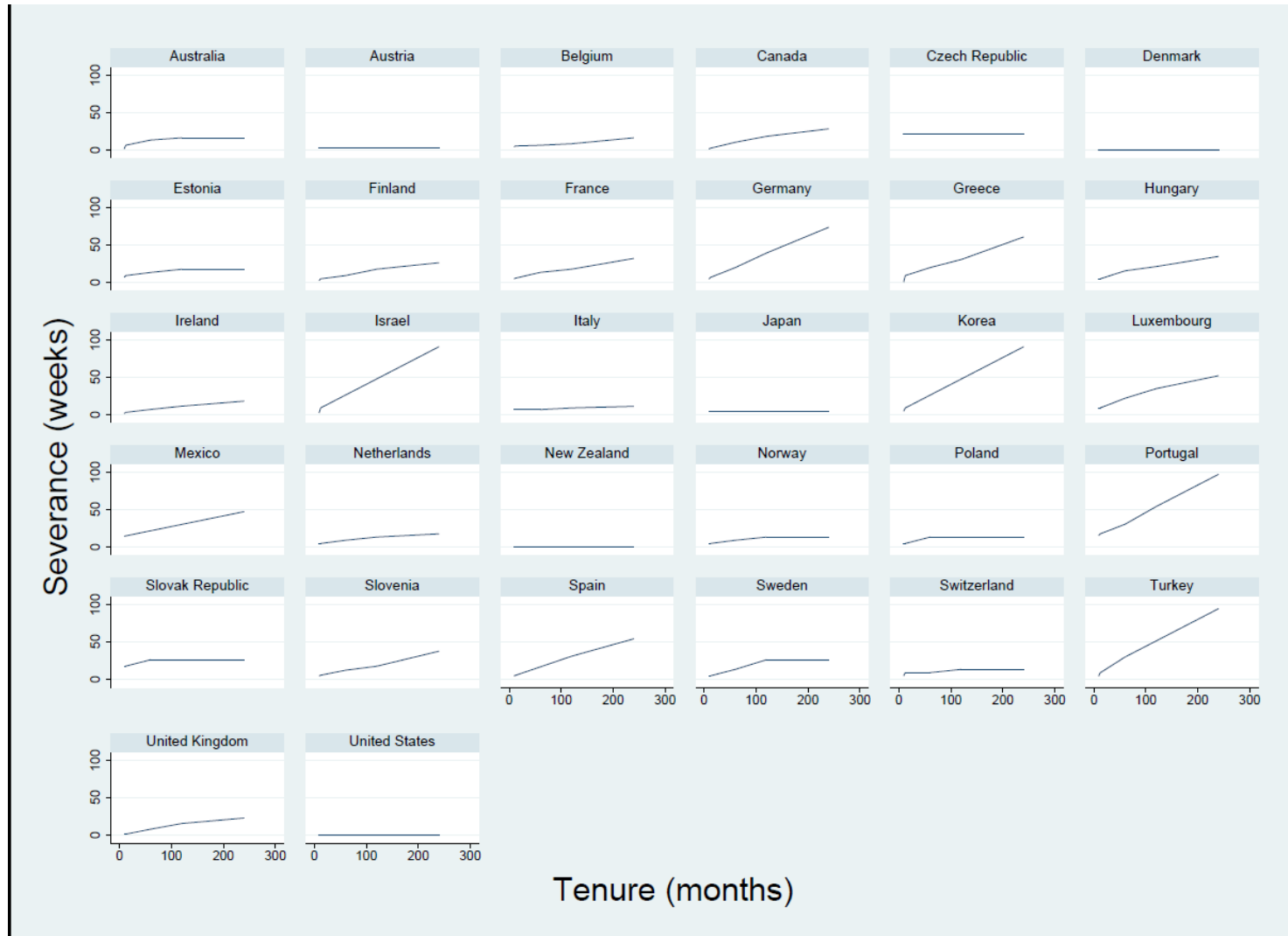
During a Recession II

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- **Layoffs side.** Even if firing declines proportionally at all ages, it would hit more the youngsters because of the higher levels to start with.
- Moreover employment protection is stronger on those with longer tenures

Severance - Tenure Profiles

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Proportional Effects

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- Problem felt in high unemployment countries
- Young workers suffer much more in recession in high unemployment countries than in low unemployment ones
- When adult unemployment in Spain went up from 9% to 20%, youth unemployment went up to 40%!
- But when unemployment in Denmark went up from 4% to 7%, youth unemployment went up to just 14%

Structural Problems

- Contractual Dualism (temporary vs. permanent contracts)
- The transition from school to work : the educational mismatch in Europe, the skill mismatch in emerging economies

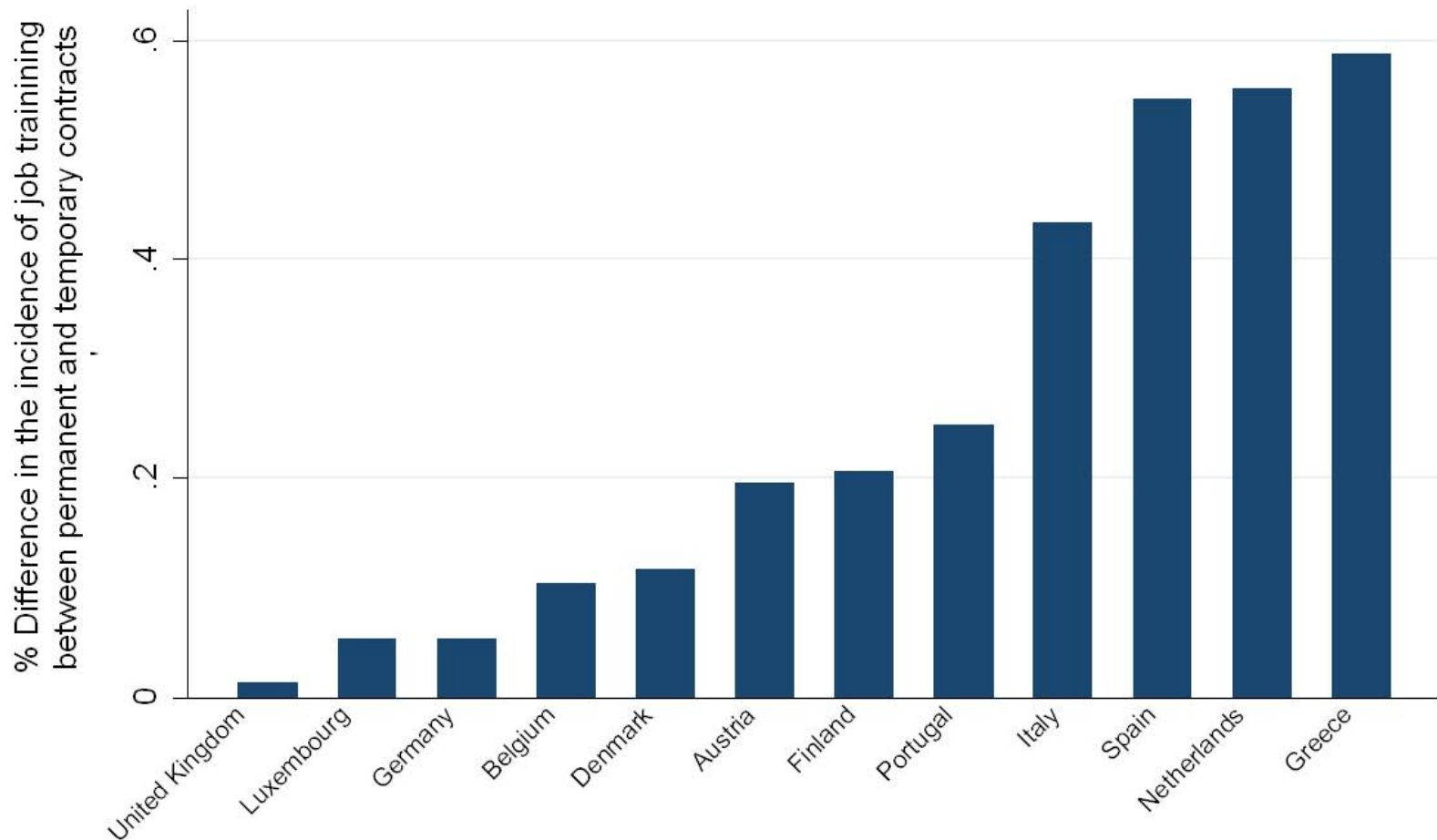
Dualism of Labour Market

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- Dualism temporary-permanent contracts contributes to explaining the “significant improvements in the youth labour market observed **prior** to the crisis”. However, it also increases job losses during recessions and make them concentrated on young workers.
- Dualism increases the volatility of employment. Bad during recessions (large job losses), not so bad during upturns (honeymoon, job creating effect)

The human capital loss associated with Dualism = less on-the-job training

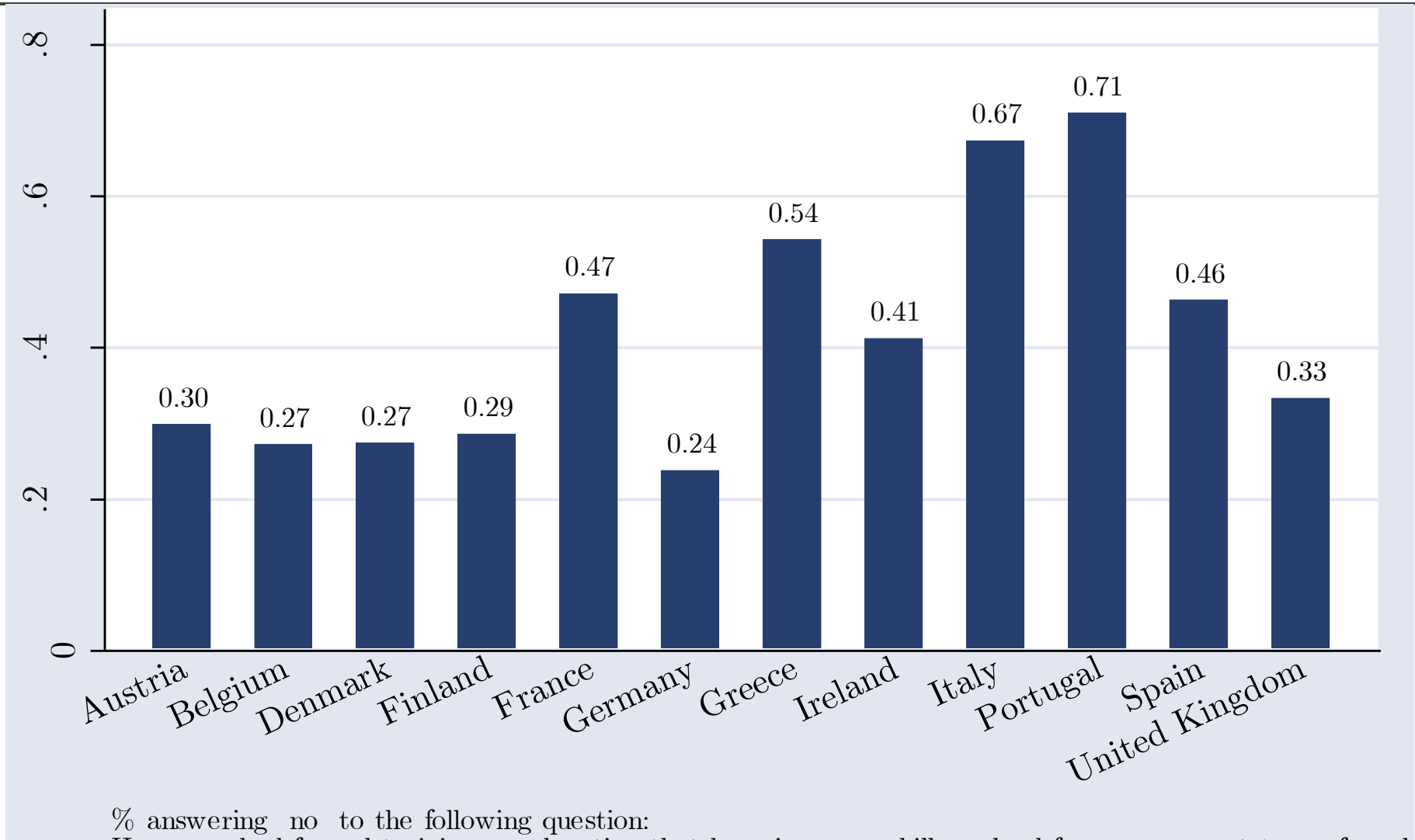
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Source: ECHP

The Educational Mismatch

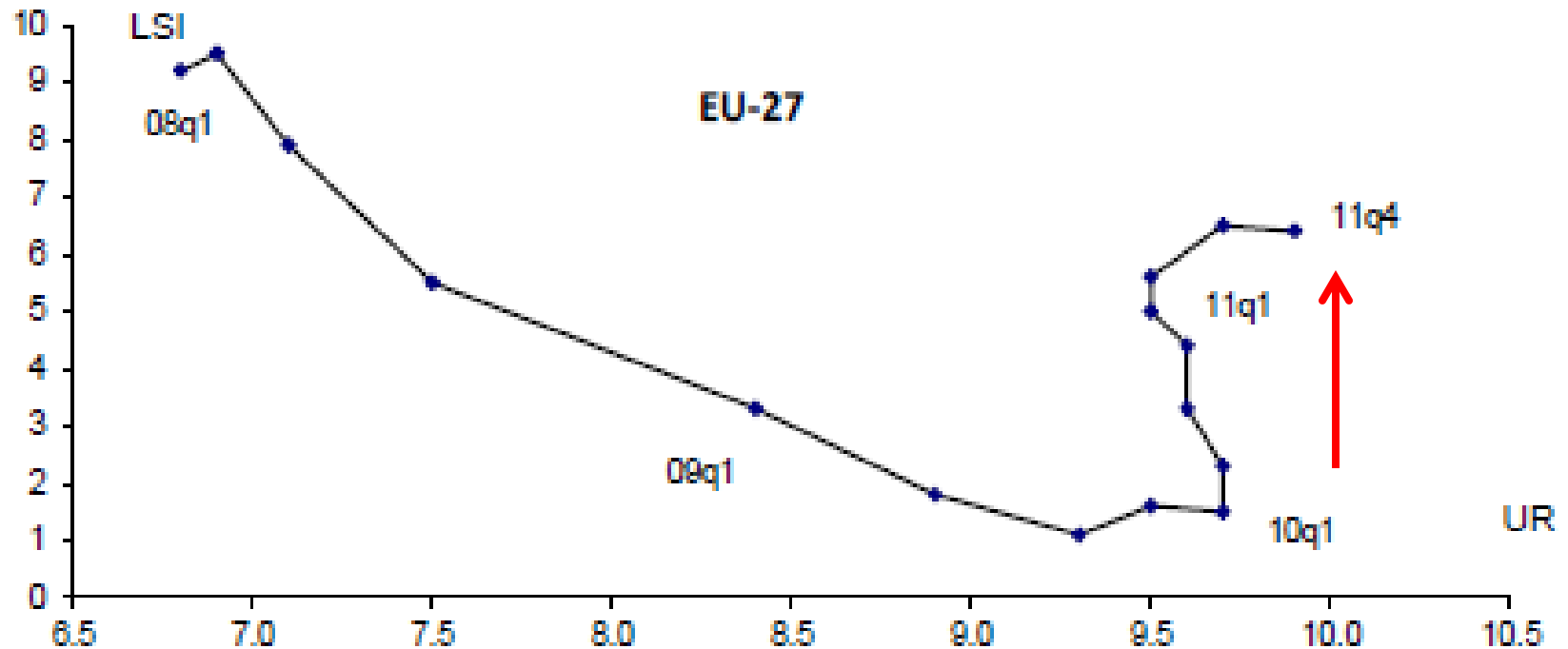
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Increased skills mismatch?

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Outwards shifting Beveridge Curve



UR = unemployment rate

LSI = labor shortage indicator (number of employers reporting “shortage of labor” as factor limiting production)

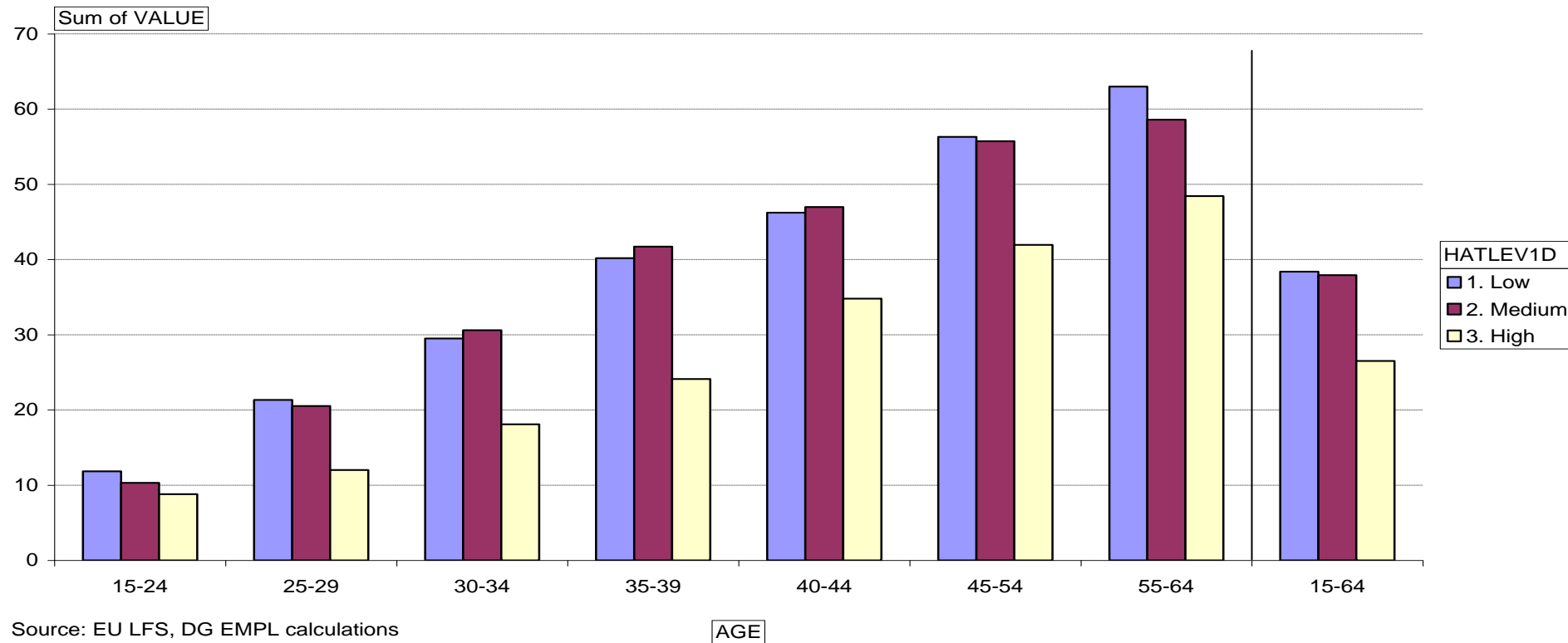
Source: EU Employment and Social Situation Quarterly Report, March 2012

Low-skill workers hit harder than high-skill at all age

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D B

YEAR|2,008|SEX|TOTAL|INDICE|DURATION|COUNTRY|EU

**Time (in months) since an unemployed person last worked breakdown by education level in 2008
- age profile -**



Source: Employment in Europe 2010, European Commission

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Can we do anything about it?

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- Little to do with respect to physiology of youth U during recessions
- We can do a lot about human capital loss involved by dualism and educational mismatch
- Single contract for labor
- An advanced (tertiary) vocational system

Dealing with Dualism

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- **Phasing out temporary contracts *now* could deliver worst outcome**
 - large job losses during the recession
 - but limited job gains when the recovery comes
- **Policy needs to balance at least two forces**
 - Let firms enjoy flexibility at entry. On the labor demand side, firms benefit from a labor market where experimentation is allowed
 - Set a well defined path to stability for workers, through a long-run entrance with an open ended labor contract term

Contrato Unico, Contratto Unico di Inserimento, Contrat Unique

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Proposals developed in Spain (100 academic economists, draft bill), France (Blanchard-Tirole, Cahuc-Kramarz) and Italy (Boeri and Garibaldi, draft bill): tenure track to stable jobs with protection increasing with tenure.

Common philosophy, but structure tailored to country-specific regulations.

Il Contratto Unico di Inserimento

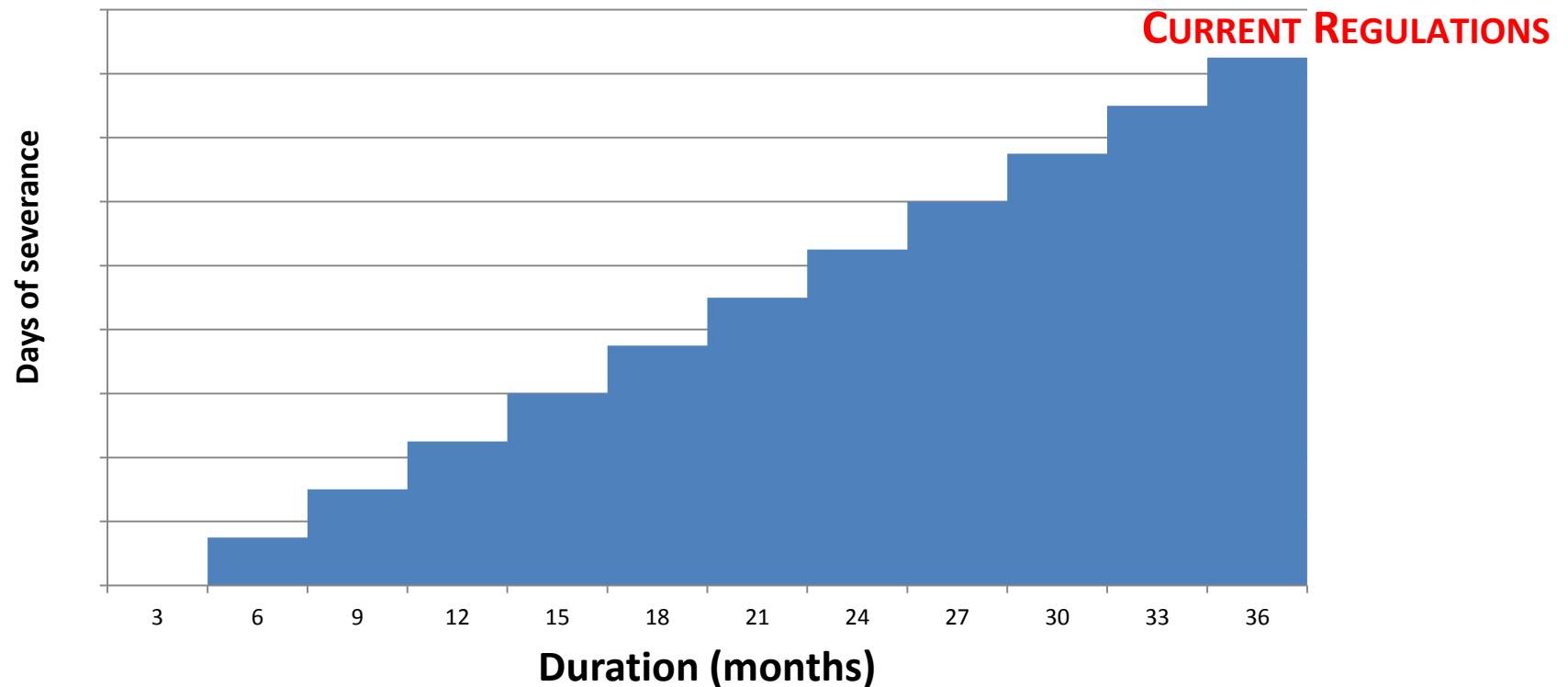
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Italian draft bill differentiates entry through experimentation from genuinely fixed term jobs. Open ended contract with two phases:

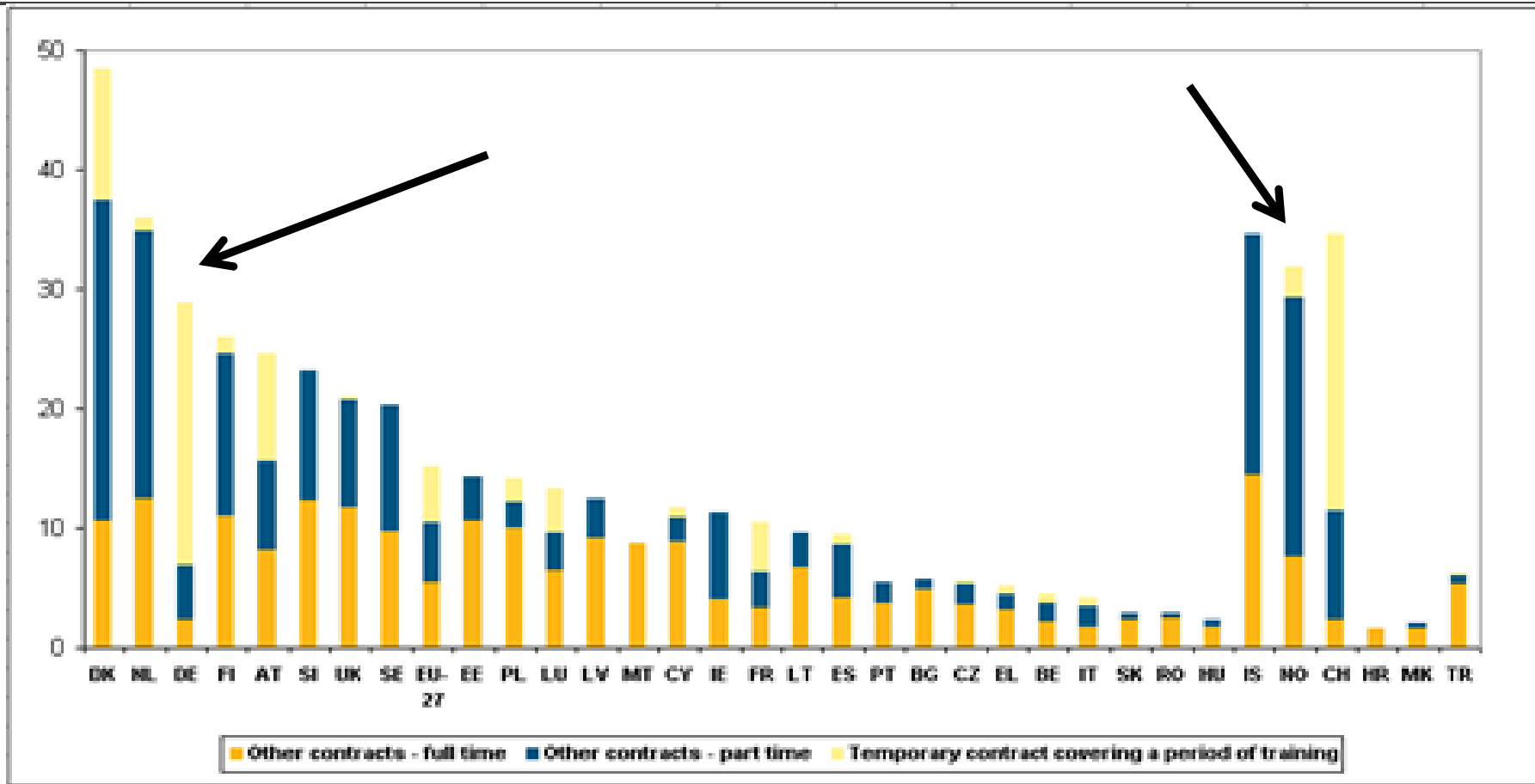
- *Entry Phase* (up to the third year): the worker has the right to severance payments proportional to tenure (independently of firm size): dismissal without just clause requires up to six months in severance payments (5 days of severance every month). Entry phase lasts three years
- *Stability Phase* (from third year onward): current legislation (for dismissal without just clause: reinstatement right in firms above 15 employees and six months severance in small firms)
- Fixed term contracts and de-facto dual workers (yet self employed in the books) only with high salaries and higher contributions to unemployment benefits. Employers must pay for higher flexibility

A Graded Tenure Path

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Combining education and training: some countries succeed



Fraction of workers aged 18-24 combining education and employment, 2009

Source: Eurostat

A tertiary vocational system

- Along the German *Fachhochschule* system
- 50% of education in the university, 50% in the firm
- Mutual control over quality of training
- Development of readily marketable skills
- Good also for emerging economies. Some evidence of overeducation and brain drain.

European Youth Employment Initiative

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- 6 billion in 2014-15 plus unspent structural funds
- Youth Employment Guarantee: measure to mobilise labor supply, but problem is on labor demand side!
- Risk of congestion effects
- Better subsidies or employment conditional incentives for low wages
- And mobility related to dual education systems

Conclusions

- **In the aftermath of the Great Recession**
 - a new **social challenge** emerged in Europe
- **Can not forget an entire generation of workers**
 - Need to stabilize employment
 - Reduce skill mismatch and help accumulation of skills favorable to economic transformation and growth
- **Crucial challenges for policy**
 - Promote frameworks to facilitate a shift toward regular employment
 - Promote vocational training and human resource development
 - Change interaction between industry and academia
- **Need to define a strategy also at the European level**