Scarred Generation

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THE recent global economic crisis took an outsized toll on young workers across the globe, especially in advanced economies, which were hit harder and are recovering more slowly than emerging market and developing economies.

Young people have always had a tough time finding work. Historically, the unemployment rate for those ages 15 to 24 in advanced economies has been two to three times higher than for older age groups. But since the global crisis began in 2008, young people have suffered a much sharper rise in joblessness than older workers, and structural issues—especially in Europe—have exacerbated youth employment problems.

Unemployment can exact a big personal toll on young people. Failure to find a first job or keep it for long can have damaging long-term consequences on their lives and career prospects. But youth unemployment also has broader social consequences and contributes significantly to growing income inequality in advanced economies.

Bad, then worse

In 2007, the year before the global recession began in earnest, young workers were already in trouble. Unemployment among workers ages 15 to 24 in advanced economies averaged 13 percent, compared with about 5 percent among older workers. The unemployment rate among those young workers has now climbed to nearly 20 percent, three times the roughly 7 percent average that prevails in older age groups. And because advanced economies are recovering so slowly, the rate is likely to remain high for some time.

Youth unemployment has varied widely across countries. Although just before the crisis it averaged 13 percent in advanced economies (Australia, Canada, Japan, Korea, New Zealand, the United States, western Europe), in Greece and Italy the youth unemployment rate exceeded 20 percent, in the Netherlands and Japan it was less than 10 percent, and in the United States it was about 10 percent. In several countries, including Sweden and the United Kingdom, youth unemployment was four times greater than that of adults.

Since 2008, youth unemployment has increased (see chart)—in the United States it climbed to more than 18 percent, and in Italy and Sweden, it is about 25 percent. The biggest increase was in Spain, where youth unemployment doubled, from less than 20 percent in 2008 to almost 40 percent three years later. In Germany, however, youth unemployment fell, thanks to well-functioning apprenticeship programs and the intro-

In advanced economies, the crisis sparked a huge increase in unemployment among younger workers that will take a long time to abate

duction of short-time working policies that subsidize firms when they reduce hours rather than lay off workers during a business slowdown. Young German workers, however, are still one and a half times more likely than adults to be unemployed.

But it is not only the overall unemployment rate that is worrisome. Equally alarming is the length of time young workers are unemployed, often while seeking their first job. Two of every ten unemployed youths in advanced economies have been seeking a job for a year or more. In the euro area countries, the ratio is even higher, at 3 out of 10. The highest incidence is in Spain, where 40 percent of young workers have been seeking a job for more than 12 months. Workers unemployed for an extended period lose their skills and their ties to the workplace. Growing frustration over unemployment has also led a large number of discouraged youths to give up looking for a job—so it is likely that unemployment statistics understate the joblessness picture.

Hard to find

Young people usually have more trouble finding a job than do older workers for many reasons. They have less work experience, less knowledge about how and where to look for work, and fewer job-search contacts. In addition, many young people lack the skills employers need, often because of backward-looking education systems. As a result, for many young people the transition from school to work is bumpy and sometimes long, and now is even more arduous because of the crisis. Even those who find jobs are more vulnerable than older workers, especially in economic downturns, because the last hired tend to be the first fired.

But there are also labor market practices, especially in Europe, that add to long-term problems. Young people are more likely than older workers to work under temporary contracts. Almost a third of employed youths in advanced economies held such contracts before the crisis. In boom years, companies relied heavily on temporary workers—largely to get around regulations that make it difficult to fire permanent workers. As the economy contracted, the temporary workers were among the first let go; moreover, many did not qualify for company-paid severance—not only was it easier to fire them, it was cheaper. Half of young workers in Spain were on temporary contracts before the crisis and were the first to lose their jobs. Young workers often face a double whammy when they are let go. Not only do they lose the job, they often have less access to social welfare benefits.

Scarring effects

In addition to the short-term problems unemployment causes for young people, it has long-term debilitating effects. Studies have shown that those who experience unemployment early in their life are more likely to be unemployed again in later years. Moreover, they are likely to earn less over their working life than are their peers who find jobs more easily (von Wachter, Song, and Manchester, 2009; Kahn, 2010). Experts call the negative long-term consequences of early unemployment "scarring effects." Those scarring effects are the result of such factors as deterioration of skills and forgone work experience. But they can also come from potential employers' belief that these workers will not be productive. The longer a person is unemployed, the longer the scarring effects are likely to last. The earnings penalty can be as high as 20 percent compared with their peers who find employment early, and the earnings deficit can persist as long as 20 years.

The adverse effects on lifetime earnings are most pronounced for unemployment experienced in youth, especially at the time of college graduation. Those who entered the job market during Japan's so-called lost decade of the 1990s, for example, experienced such scarring effects. Long-term youth unemployment more than doubled and persisted well after the recovery began, because Japanese employers preferred to hire recent graduates rather than those trapped in long-term unemployment or persistent inactivity.

In addition to harmful effects on future wages and employability, studies find evidence that spells of unemployment for a young person often hurt the individual's happiness, job satisfaction, and health for many years thereafter.

High costs

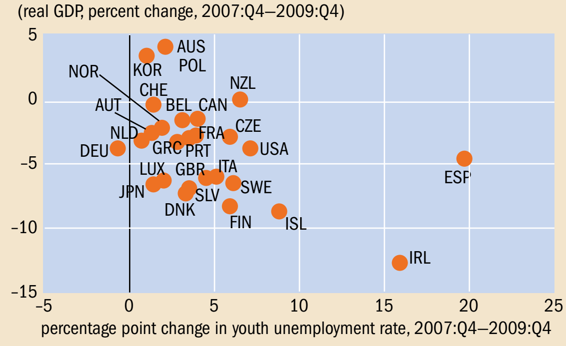
Youth unemployment can also lead to high economic and social costs for society. Underutilization of young people in the labor market can result in a vicious circle of intergenerational poverty and social exclusion. Lack of employment opportunities may trigger violence and juvenile delinquency. Recent high youth unemployment has contributed to social unrest in many countries—advanced, emerging, and developing.

Income inequality, a growing problem in many advanced economies, is made worse by rising youth unemployment. Extrapolating from the underlying factors between 1980 and 2005 that caused income inequality in advanced economies that are member of the Organization for Economic Cooperation and Development (OECD) shows that the global crisis will exacerbate inequality, mainly by increasing

A sinking feeling

Except in Germany, the youth unemployment rate rose during the global crisis—increasing by more than 20 percentage points in Spain and by nearly that much in Ireland.

(real GDP, percent change, 2007:Q4–2009:Q4)



Source: Organization for Economic Cooperation and Development.

Note: AUS = Australia, AUT = Austria, BEL = Belgium, CAN = Canada, CZE = Czech Republic, DNK = Denmark, FIN = Finland, FRA = France, DEU = Germany, GRC = Greece, ISL = Iceland, IRL = Ireland, ITA = Italy, JPN = Japan, KOR = Korea, LUX = Luxembourg, NLD = Netherlands, NZL = New Zealand, NOR = Norway, PRT = Portugal, SLV = Slovenia, ESP = Spain, SWE = Sweden, CHE = Switzerland, GBR = United Kingdom, USA = United States.

unemployment and inhibiting job creation (Morsy, forthcoming). Youth unemployment contributes significantly to rising income inequality.

The increase in youth unemployment during the crisis is estimated to have raised income inequality, measured by the Gini coefficient, by 4 percentage points among all advanced economies and by as much as 8 percentage points in the countries on the periphery of Europe—Greece, Ireland, Italy, Portugal, and Spain—where the youth labor market deteriorated much more than in other countries. The Gini coefficient measures inequality on a scale of zero to 100, with zero denoting perfect equality of household income and 100 representing a situation in which one household has all a society's income.

The more a country's employers hire workers on temporary contracts, the higher the level of inequality.

The global crisis also produced more "discouraged" workers, young and old, who dropped out of the labor force, which likely further exacerbated income disparity. The rise in youth unemployment rates further widened the gap between rich and poor. Spain and Ireland are estimated to have suffered the largest deterioration in income distribution: a rise in income inequality of 18 percentage points and 12 percentage points, respectively. This reflects large job losses in construction, a major source of employment for many low-skilled young workers. Close to half of the unemployment contribution to inequality in these countries can be attributed to long-term unemployment. By contrast, inequality barely changed in Germany and the Netherlands, where the cost of firing workers and programs to support part-time work propped up employment. The effects of unemployment on inequality might have been even greater without advanced economies' extensive social safety nets.

The analysis of OECD data also indicated that the more a country's employers hire workers on temporary contracts, the higher the level of inequality. This gap is particularly noticeable in countries such as Spain and Portugal that relaxed regulations on temporary contracts while maintaining strong employment protection for permanent workers.

Resolving the problem

A healthy recovery accompanied by job creation will bring down youth unemployment, improve income distribution, and strengthen social cohesion. But recovery alone won't be enough to prevent many of today's young people in advanced economies from marginalization and exclusion from the workforce.

Some essential far-reaching labor and product market reforms include the following:

• *Addressing the mismatch between the skills students acquire and the needs of employers:* This will go a long way toward helping reduce long-term youth unemployment. Policies should ensure that the education system prepares young people for the skill demands of employers through outreach programs, training, apprenticeships, and access to job-search assistance measures. Governments could entice private employers to hire more young people by such actions as reducing employer social security contributions for new hires and/or subsidizing firms that hire long-term unemployed, low-skilled youths.

• *Relaxing protections for regular workers, while enhancing them for temporary workers to support job creation:* A pervasive dual labor market system, with a flexible temporary workforce and a highly protected permanent workforce, can increase unemployment (Blanchard and Landier, 2002; Dao and Loungani, 2010). Easing regulations only for fixed-term contracts strengthens the power of permanent workers in wage bargaining, which pushes up wages and makes it harder for others to get hired. This is why both steps must be taken together.

• *Fostering competition and creating a more business-friendly environment:* Such steps would open up various sectors to new firms, promoting both innovation and efficiency and in turn stimulating private investment and employment. Policies should remove entry barriers and reduce operating restrictions in sectors such as services, retail, energy, and telecommunications. Studies have shown sizable employment gains when labor market liberalization is accompanied by more competitive product markets.

Not all these reforms yield immediate gains, but they are necessary to deal with the chronic unemployment problem.

The energy, skills, and aspirations of young people are invaluable assets that no society can afford to waste. With a significant and growing proportion of young people at risk of prolonged unemployment, the potential negative long-term scars to their careers, earnings, health, and well-being could be profound. Moreover, the economic and social costs associated with youth unemployment, including greater income inequality, are high. It is important to introduce policies to enhance the skills and capabilities of younger workers and assist them in joining the labor market as quickly as possible. ■

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