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Youth employment in europe: do institutions and social capital explain better than mainstream economics?

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Abstract

Why did employment growth - high in the last decade– take place at the expense of young workers mainly, but not only. in the countries of Southern Europe? Youth unemployment is now exceeding 30%, after decades hovering around 20% and over, despite a variety of factors, common to most EU countries, that would be expected to reduce its evolution: population ageing and the demographic decline, low labor cost of young workers, flexibility of working arrangements, higher educational attainment, low unionization of young workers, early retirement practices of workers 50+. But neither seems to provide a convincing explanation for countries of Southern Europe. Historically based institutions and political tradition, cultural values, social capital – factors that go beyond the standard explanation of economic theory – provide a more satisfying interpretation.

JEL classification: J0, J6, J23, F01, F16

Keywords: EU labor market institutions & LM performance

Introduction

Why did employment growth - high in the last decade– take place at the expense of young workers in the countries of Southern Europe? This is the question addressed in this paper. Youth unemployment has approached or exceeded 20% despite a variety of factors, common to most EU countries. According to neo-classical economics all such factors would be expected to exert a positive impact on the work opportunities of young people: population ageing and the demographic decline, low labor cost of young workers, flexibility of working arrangements, higher educational attainment, low unionization of young workers, early retirement practices of workers 50+. But neither seems to provide a convincing explanation for countries of Southern Europe. Historically based institutions and political tradition, cultural values, social capital – factors that go beyond the standard explanation of economic theory – provide a more satisfying interpretation. My paper develops this interpretation. In this sense, it may be viewed as a new contribution to a problem that economists have mainly addressed with case studies of specific countries, neglecting the influence of G. Esping-Andersen's categorization of three "worlds" of welfare capitalism since the early Nineties,[1] and the general intuitions that it provided.

Youth unemployment in Italy, Spain, Portugal, Greece and France has hovered around and above 20% (well before the 2008 crisis), with employment-population ratios below 40% against 50% and over in the countries of Northern

[1] Esping Andersen, G. (1990), The Three Worlds of Welfare Capitalism, Princeton U. Press.

Europe (and Austria). In principle, long term GNP growth should be an important driving factor, but the empirical evidence is weak: growth has been high also in member states of Southern Europe (Spain and Greece) where youth employment has been lagging, while it has been modest in some Scandinavian countries where it fared much better.

Workforce ageing has been a common feature all over the EU: had natural replacement of the retiring cohorts taken place evenly in the EU, the impact on youth employment should have been roughly the same everywhere. But it did not: in first place retirement age has a wide cross-country variability. Secondly, youth employment and old age employment appear to be complementary rather than substitutes in several countries, here again especially of Northern Europe.

A closely related argument is the demographic decline after the baby boom of the Sixties. The decline hit Southern Europe where youth employment suffered the most, more than the rest of the continent. This is yet another surprising fact, as there is no reason to expect that, in addition to the direct impact on the size of labor supply, the demographic decline should decrease youth participation. To the contrary, if aggregate demand, skills and productivity were constant, a larger proportion of the fewer young people remained, would be called at work.

My exploration rests on simple associations between macro indicators of labor market performance, demography and institutional characteristics: I display the results of linear bivariate regressions as purely descriptive representations which carry no causal interpretation. In order to perform a more sophisticated analysis, historical (and sufficiently standardized) data on various aspects of labor market developments would be necessary. But many are simply absent from official international sources: resorting to national statistics is possible, but the task of insuring a minimal degree of cross-country comparability is a research project in itself, beyond my reach. Cross-country comparative explorations provide a number of advantages over national studies. They make use of large and institutional variations unobservable within single countries, helping to assess the extent to which results are country-specific, and whether effects are systematically heterogeneous in different settings. The price to be paid is the limited number of country observations. All the data used in this paper (except one series provided by the World Bank) are drawn from the OECD Statistics Databases. Not all data are available for each country and each year. Therefore some charts present annoying drawbacks, such as comparisons of data not necessarily associated to the same years or long differences and growth rates computed on observation periods that may differ. Even a simple factor analysis cannot be implemented under these conditions. In any case, however, it would provide very modest additional insight compared to the simple correlation coefficients provided for each chart. For these anomalies I do apologize.

While rough empirical tests like the one I perform here cannot yield a complete and articulated explanation, they do provide insightful flashes that

sketch a simple tale of stylized facts of the European economies in a socio-political as well as economic perspective. In particular, they highlight that the best performing countries look "best" in almost all dimensions considered, including (and, perhaps, especially) the socio-political-cultural ones, while the opposite holds for the "worst" performing ones.

The paper is organized as follows. Section1 introduces the background story and surveys a few of the main contributions to the problem. Sections 2-5 illustrate why the traditional arguments of mainstream economics fail to explain the developments in Southern Europe. Various potential driving factors of the employment differentials are discussed in section 2: demography and school attainment (section 2.1); economic growth (section 2.2); skill mismatch (section 2.3); complementarity and substitution between youth on one side and women and the young elderly on the other (section 2.4). A preliminary examination of how the welfare state and the institutions impact on young people's labor market is addressed in section 3. Wage rigidity is the argument of section 4; the role of mobility and flexibility of section 5. In section 6, towards the end of my exploration, I argue that mainstream economics provides only partial explanations of the indeed remarkable cross-country differences between Southern Europe and the rest of the EU. Alternative explanations to the persistence of employment differentials call for categories that are often absent from economic analysis: family, institutions, rule of law, civic values, political tradition. A short conclusion is left for the last section 7.

1. The background story

The problem of European unemployment has spurred an immense amount of deep thought among the academics, especially in the last decades of the century when it became clear that the EU natural unemployment rate was climbing from a relatively untroubled 5-6% to a worrisome 8-9% and progressively leading to hysteresis. A variety of reasons had been given to explain this development: (i) the interactions of supply shocks with real and monetary rigidities (M. Bruno and J. Sachs, 1985) and with differences in collective bargaining structures (L. Calmfors and A.Driffil, 1988); (ii) the tight monetary policies in the Eighties that curbed inflation and had adverse effects on employment (C. Bean, 1993); the persistence mechanisms with lasting effects on unemployment, in first place the role of insiders in collective bargaining (A. Lindbeck and D. Snower, 1990; O.Blanchard and L. Summers, 1989); the adverse effect of long term unemployment on human capital, skill obsolescence and stigma (R. Layard and S. Nickell, 1987); the labor market rigidities (OECD Jobs Study, 1994), accompanied by lower trade barriers and higher integration, all leading towards increased turbulence of the world economy and ill adapted institutions (G. Bertola et al., 1990 and 1994).

Sociologists and political scientists too have widely contributed to the debate on youth unemployment. Despite the remarkable influence of Esping-

Andersen's categorization of three "worlds" of welfare capitalism, economists have largely neglected investigation of his ***dimensions*** of welfare state policy and politics that, as will emerge in the course of my argumentation, turn out to be one of the keys to interpret the events.

Since the turn of the millennium, while overall employment was back on the rise, youth employment was still lagging behind in many EU member countries, and a source of considerable preoccupation. As a matter of fact the European Union has had youth employment on the agenda for at least two decades. Since the mid Eighties, all EU countries have moved in the direction of labor market deregulation and contract flexibility, with the principal aim of enhancing job opportunities for the young.

Before the 2008 crisis – I will not deal with the post-crisis events - about 37% of young Europeans aged 15-24 were in employment, with huge differences among countries ranging from 68% in the Netherlands and 21% in Hungary. Many youth of this age group were still in education, be it general education, vocational education or training. During 2005-2008, characterized by a positive business cycle, progress was been made in reducing youth unemployment which fell on EU-27 average from 18.3% in 2005 to 15.3% in 2007. Nonetheless, differences among member countries were remarkable, with several countries struggling with youth unemployment rates above 20%.

The problem of making room for new and safe job opportunities is not limited to young people. Especially in Southern Europe it touches upon the so-called "secondary" segment of the workforce: women, the "young elderly"(50+) forced to take early retirement, the unskilled segment of the workforce including the vast majority of immigrants, all belong to the weak fringes of the labor force for which better working conditions are badly needed.

The risk of progressive dualization of the labor market has been the object of important warnings (Blanchard and Landier, 2001; G. Saint-Paul, 2004): while the insiders, workers with permanent open-end contracts, are relatively sheltered by the welfare institutions, the protection afforded to the outsiders is minimal. The number of outsiders, especially the young ones, has risen at formidable rate in the last decade: even at the age of 29 only half of the EU population is in a stable employment position: involuntary part-time or limited contract work remains a big problem also in this age group, as it puts serious constraints on one's life style impacting on morale, mental health, expectations, delaying family formation and fertility, etc. It is also argued that the dramatic spread of temporary jobs in Continental European countries is the consequence of the combination of stringent legal constraints on the termination of permanent jobs and of weak constraints on the creation of temporary jobs. This combination is bound to create labor market segmentation and to trap workers in a recurring sequence of frequent unemployment spells.

The accumulation of human capital is at risk: in the short run higher flexibility may generate suitable matches between employers and workers and, possibly, higher efficiency in the economy. In the long run, however, a higher turnover decreases the incentive to invest in human capital, both from the company's and the worker's point of view, thereby reducing productivity and hampering economic performance and future growth.[2]

A comparative look at the growth rates of employment and GNP in the 2000-2008 period (Tab. 1) sheds some preliminary light on the medium-long run issue, and provides a useful background for the rest of the story.

Tab. 1 OECD: 2000-2008 growth rates and multi-factor productivity (MFP)

		Empl.	**GNP constant prices**	**Labor productivity**	**1985-95 MFP**	**1995-07 MFP**	**2001-07 MFP**
Austria	Au	8.2	23.4	15.1			
Belgium	Be	6.7	16.0	9.3			
Denmark	Dk	3.9	10.4	6.5	1.5		0.6
Finland	Fl	8.4	25.0	16.6	1.3	0.3	1.6
France	Fr	5.8	14.1	8.3	1.7	2.1	1.0
Germany	Ge	6.0	9.7	3.7	1.4	1.1	0.6
Greece	Gr	11.8	35.8 (*)	24.0		1.0	
Ireland	Ire	26.1	43.4	17.3	3.3	3.5	2.5
Italy	It	10.3	7.3	-3	1.3	0.1	-0.7
Netherlands	Nl	7.7	16.5	8.8	1.0	0.8	0.7
Portugal	Por	3.1	7.9	4.8		1.2	0.3
Spain	Sp	29.9	28.0	-1.9		0.1	-0.1
Sweden	Swe	10.4	19.8	9.4	0.5	1.8	2.7
United Kingdom	Uk	8.5	20.4	11.9	1.0	1.2	1.2

(*) The remarkable GNP growth of Greece can be probably ascribed to the disastrous and fallacious public debt management run by the Greek governments and disclosed only very recently.

[2] Recent face-to-face interviews with personnel managers of large Italian firms revealed that while the practice of hiring young people via atypical contracts is still widely utilized as a cost-saving device, serious doubts on their long run profitability are now being raised: the prospect of likely turnover at the end of the contract acts as a disincentive to serious engagement of the newly hired. They are often scarcely motivated, absenteist, non-cooperative, despite the perspective of being reconsidered for an open-end position at the end of the contract if a good reputation is earned in the interim.

As mentioned before, employment witnessed a substantial increase since the turn of the millennium, with the exception of Denmark and Portugal. Spain and Ireland top the list with peaks over 25%, but many other countries approach or exceed a 10% growth rate. As a consequence unemployment rates have declined almost everywhere. The inter-country variability of GNP growth has been high. The interesting features come from average productivity, measured by the difference between GNP growth and employment growth: many of the smaller countries show an impressive outcome (with the UK and, to some extent France, performing very well too). Labor productivity growth in Spain and Italy, instead, became negative, and so did multi-factor productivity since 2001. This finding suggests that the wide utilization of high-flexibility, low-pay contracts in Spain and Italy – enhanced by the labor market reforms of the last twenty years - may have been among the driving force behind these developments.[3]

In the next decades demographic trends ought to improve the work perspectives of young people: the cohorts of the baby-boomers will begin to retire by 2020-25, and their replacement will increase the demand of young workers. On the other hand, the labor shortage will also spur new and massive migration inflows of largely unskilled people from non EU-countries with high fertility rates. This will be a cause of additional governance problems for the European Union, as social unrest will not cease to hide behind the door.

The key question is therefore: why did employment growth – high in the last decade – take place at the expense of young workers in the countries of Southern Europe (including France).

From a cross-country, comparative perspective, these long developments defy simple economic explanations. Youth unemployment has approached or exceeded 20% despite a variety of factors, common to most EU countries, that would be expected to reduce its evolution: workforce ageing and the dramatic demographic decline after the baby boom, the low labor cost of young workers relative to adult ones, the flexibility of the new working arrangements, the higher educational attainment, the low unionization of young workers, the early retirement practices of workers 50+ (often negotiated with the unions with the intent of making room for new young entries). Could skill mismatch in Southern Europe provide an explanation to the problem of youth employment? Are these developments the consequence of over-optimistic expectations on the agenda of labor market reform and regulation aimed at enhancing youth employment (and, in some cases, somewhat mismanaged implementation), or, instead, may such negative outcomes have been exacerbated by traditional demand and supply factors? Both arguments may be correct, but neither goes at the deep root of the issue. The specific cultural and institutional framework – factors that go beyond

[3] Additional evidence of Italy's weak position vis-à-vis the rest of its direct eu competitors is signaled by the pattern of real wages: stagnant since the early nineties, while in the rest of Europe they were increasing by 10% in the market sectors, and by 20% and over in manufacturing.

the standard explanation of economic theory – provide an alternative and perhaps more convincing interpretation. Some institutions are more conducive to positive labor market outcomes than others. The Nordic countries, Denmark in particular, have been pointed as the top performers long before joining the EU, but there too questions arise: to what extent is it the heritage of the social-democratic values and culture (which have not been lost despite adverse electoral outcomes), or does their performance derive from the "small economy – low population density" advantage[4] ? The Mediterranean countries, on the other hand, are the worst performers along all the dimensions in a comparative examination.

This finding (probably not surprising to a political scientist) suggests that the driving forces of labor market outcomes may lie in the historical-socio-political-cultural sphere, at least as much as in economy-related events and reform. If this is the case, while sound economic reform and regulation may have a positive impact at the margin, they will fail to achieve the main target for years to come. A reversal of demographic trends, the not-so-distant retirement of the baby boom generation and a successful, although very difficult, integration of immigration flows, may lead in the right direction if accompanied by intelligent and very forward looking policies.

2. Bird's eye view of cross-country comparisons

2.1. Demography, participation[5] and school attendance

Demography and school attendance are the main long run determinants of young people's labor supply. Demography declined all over Europe following the baby boom of the Sixties, leading to a major shrinkage of youth labor supply. School attendance – historically the main option to youth labor market participation - was on the rise at the same time, leading instead to the fall of participation rates.[6]

[4] I will not elaborate on this problem here: it is a different and difficult one. consider, for instance, the Netherlands: it shares the social democratic values as the Scandinavian countries, and it is "small". yet, its population density is the highest in Europe. Nor is there any evidence that Scandinavian citizens are "happier" than other Europeans (some indicators – alcohol consumption, suicide rate - rather suggest the contrary).

[5] Here and in what follows I use the term "youth participation" and "youth employment rates" almost interchangeably. The procedure would be incorrect if my focus were on cyclical movements – participation reflects labor supply, employment reflects demand. It is acceptable for long run comparative explorations: the two indicators are of the same order of magnitude and highly correlated. Moreover, while nowadays youth participation is relatively homogeneously estimated on the basis of EU-wide Labour Force Survey (LFS) questionnaires, this was not the case til the mid Nineties. As a consequence time series of participation rates are unreliable for cross-country comparisons. In addition, in many LFS's young individuals are often found who report to be seeking work but have not undertaken any recent action to find a job. Eurostat classifies them as inactive instead of members of the labor force, adding to the confusion. Employment rates are less sensitive to classification problems.

[6] Other factors have cyclically co-determined the falling labor participation of young cohorts: in first place a discouragement effect due to lack of aggregate demand, but mostly the adverse substitution effect of prime age workers (the baby boomers) whose cohorts were increasing at the same speed at which the younger ones were shrinking.

Fig.1 shows the trends in demography and school attendance in 12 EU member states: a convenient indicator of the former is the youth dependency ratio (YDR), i.e. the ratio between the number of youth aged 15-24 to the population in working age 15-65 which declined by as much as 50% in 35 years; the share of youth aged 20-24 having attained secondary education (SCH) is an appropriate indicator of the latter. The negative correlation is not surprising and fairly robust.[7]

In Southern Europe educational attainment in the Sixties and early Seventies was much lower than in Continental and Northern Europe, also, not only, as a consequence of the size of the agricultural sector that employed up to 40% of the workforce, including many teenagers. It began to catch up in the Seventies and Eighties, with an immediate impact on youth participation.

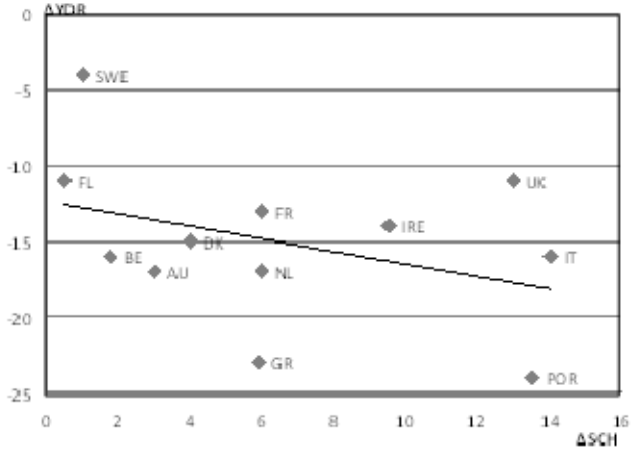

Fig.1 Demographic trends depicted by long differences:(ΔYDR 1970-2005) vs. school attainment (ΔSCH 1997–2007)
*Y = - 5 – 1.12 X ; R**2 = 0.42*

Demography and schooling are likely to converge in the long run as both are driven by deep structural dynamics, from relative backwardness to technological change and moderate affluence, affecting customs, fertility and literacy.

Demographic convergence is clearly displayed in fig. 2: there is a strong negative association between the initial YDR-1970 and the long differences ΔYDR 1970-2005: Sweden was the "oldest" country in 1970 (YDR at about 32%), and YDR decreased the least (- 5 p.p.), Portugal was the "youngest" (YDR-70 = 48%) and it decreased the most (- 24 p.p.). As a result, the between-country standard deviation of YDR is down to 2.98 in 2006 from 4.64 in 1970.

[7] Here and in all following charts the simple correlation coefficient is displayed, followed by one asterisk (*) if significant at the 90% level.

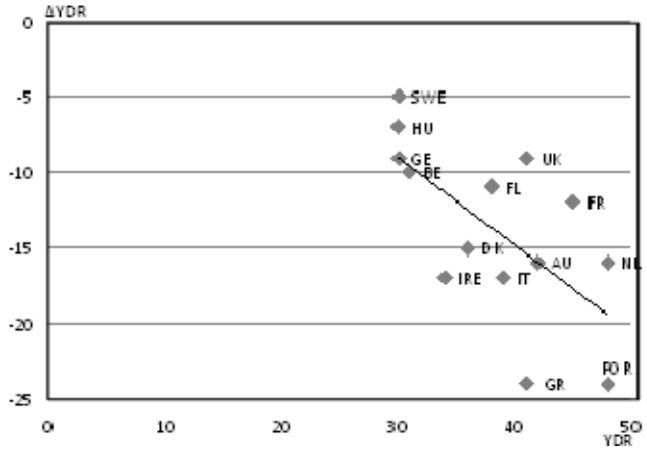

Fig. 2 Demographic convergence: long differences Δ YDR (1970-2005) vs. YDR 1970
*y = 6,2 - 0.58 x; R**2= 0.69 **

The convergence of school attainment is shown in fig. 3, where ΔSCH 1997-2007 is plotted against SCH-1997: Portugal had the highest employment share in agriculture in the early Seventies, with SCH at 40%; in the 10-year time span 1997-2007, in parallel with a drastic decline of the agricultural sector, SCH gained 14 p.p. Spain and Italy were nearly at the same level in 1997 (SCH slightly over 50%), but while Italy gained 14 p.p. by 2007, Spain lost a few points, a surprising outlier in the graph. At the other end we find the Scandinavian countries with SCH-1997 close to 90% and only a slight adjustment since.

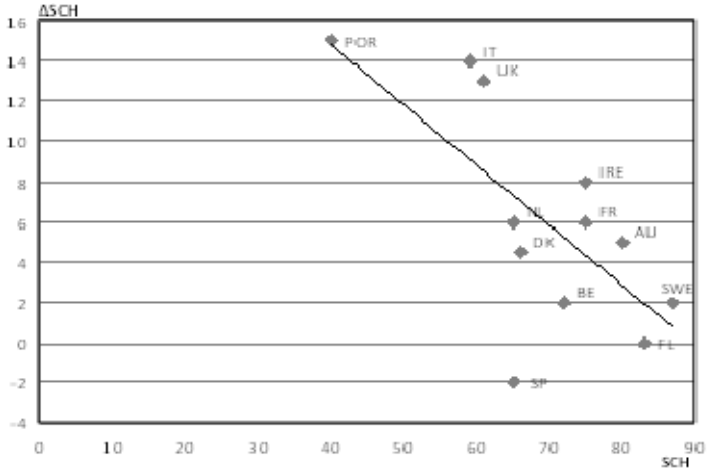

Fig. 3 Convergence in school attainment: long differences ΔSCH 1997-2007 vs. SCH 1997
*Y = 29.4 - 0.30 x; R**2 = 0.67**

The long run shift in youth labor participation vis-à-vis the demographic decline is portrayed in fig. 4. Not surprisingly, the two indicators are largely uncorrelated: a notable outlier is the Netherlands, where a large increase in YER occurred, in spite of a big demographic decline, a consequence of many years of generous measures aimed at supporting the employment (mainly part-time) of the younger and older segments of the labor force.

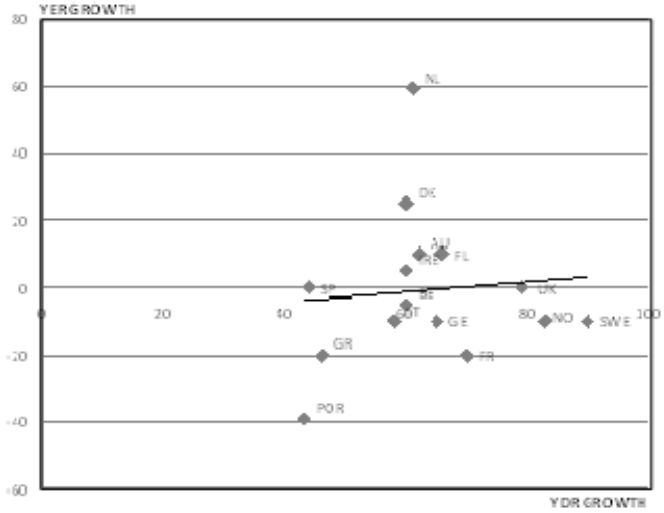

*Fig. 4 - Long run rates of change (1983-2008) of youth employment (YER) vs. youth dependency rates (YDR : y = -6.41 + 0.14 x ; R**2 = 0.08*

Fig. 5 shows instead that the demographic decline Δ YDR is positively correlated with today's employment rate (YER-2007): the countries of Southern Europe experiencing the highest decline, have a lower proportion of young people at work, and are found in the S-W corner of the plot; those of Northern Europe are in the opposite corner.

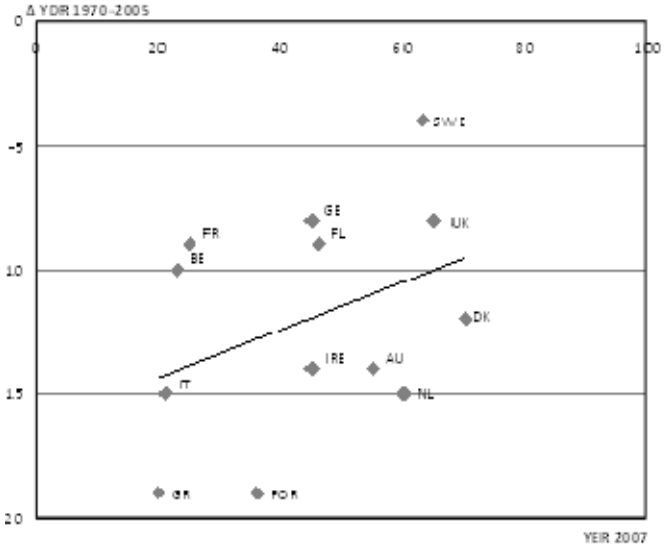

*Fig. 5 - Demographic decline: long differences Δ YDR (1970-2005) and youth employment YER 2007 y = - 16-6 + 0.10 x; R**2= 0.43**

Fig. 6 shows that the largest decline in youth participation Δ YER is found in the two countries where schooling had the highest increase in the last decade (IT and POR). At the opposite end the countries of Northern EU where Δ YER has been positive, and also accompanied by a slight increase in schooling.

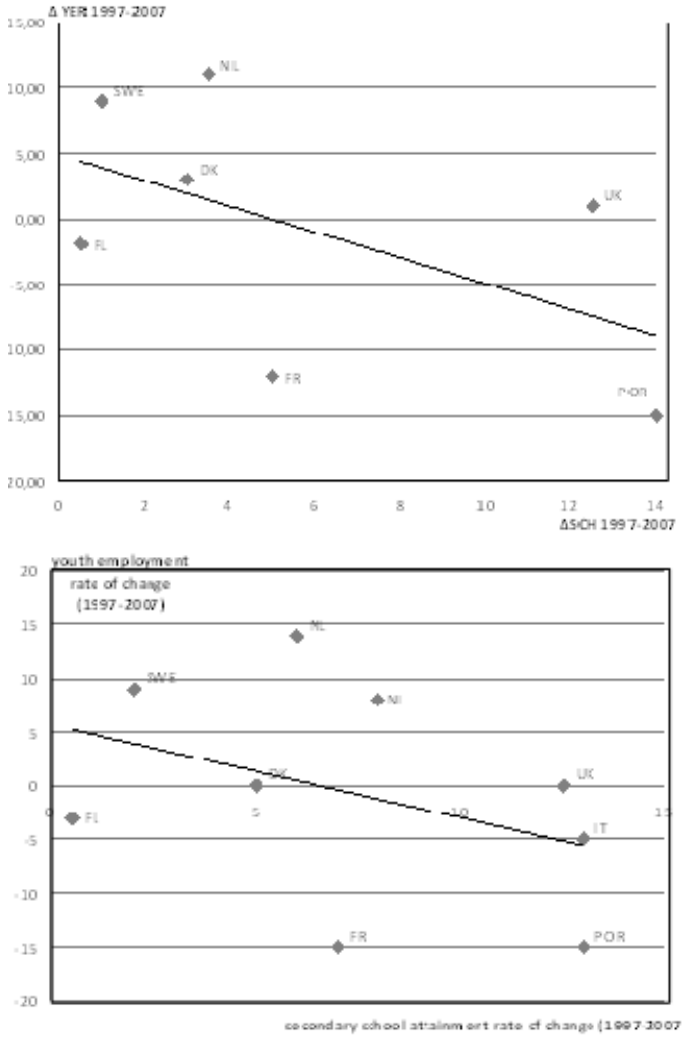

*Fig. 6 - Youth employment and secondary school attainment: growth rates (1997-2007); y = 6.12 – 0.85 x ; R**2 = 0.34*

2.2. Youth employment and economic growth

Let us now turn to the impact of aggregate economic growth. Economic theory suggests that younger societies will eventually lead to more rapid growth in the very long run. Empirical evidence has always been very difficult for a host of reasons inherent in the vast diversity of the countries' initial conditions and timing of development.[8]

A scatter diagram between the pre-2008 level of youth employment (YER) and GNP growth of the last twenty years among nine European countries (fig. 7) shows a clear positive association, interesting in its own right, but basically unrelated to the theory of development, and void of causal interpretation.

[8] For an excellent survey, see A. Deaton, "Understanding the mechanisms of economic development", Journal of Economic Perspective, vol.24 (2010).

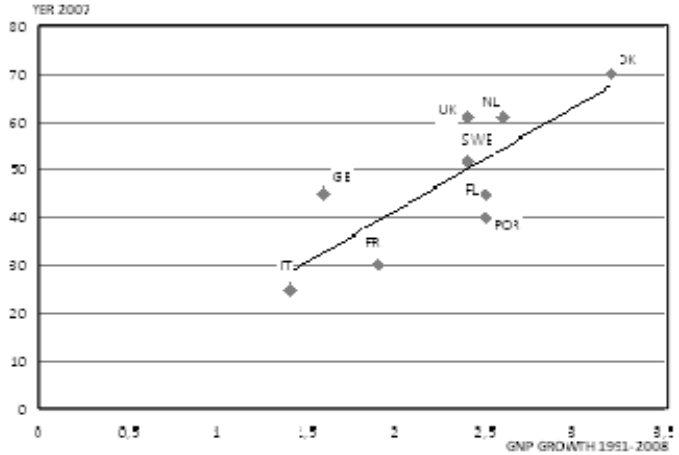

Fig 7 Youth employment (YER) and GNP growth. Long differences 1997-2007
*y = 4.65 - 0.98 x; R**2 = 0.17*

School attainment is a natural candidate to unravel the uncertain long run relation between GNP and youth employment growth. School attainment interferes on the driving effect of GNP growth on youth employment via its negative impact on labor supply. This being the case, the relevant youth employment variable will have to be net of the impact of school attainment. I therefore compute the residuals of the equation

Youth employment/population growth = f (school attainment growth) + u

which denotes the fraction of youth employment growth unaccounted for by the rise of school attainment, and regress it against GNP long run growth. Economic theory suggests a positive relation. The result is displayed in fig.8 and does not look encouraging: the slope is slightly negative, and completely devoid of statistical significance. The estimated equation of the residuals is as follows, where L(X) = growth rate (X):

$residuals_i = [L_i (YER/POP) – L_i\hat{}(YER/POP)] = a + b [L_i (GNP)]$

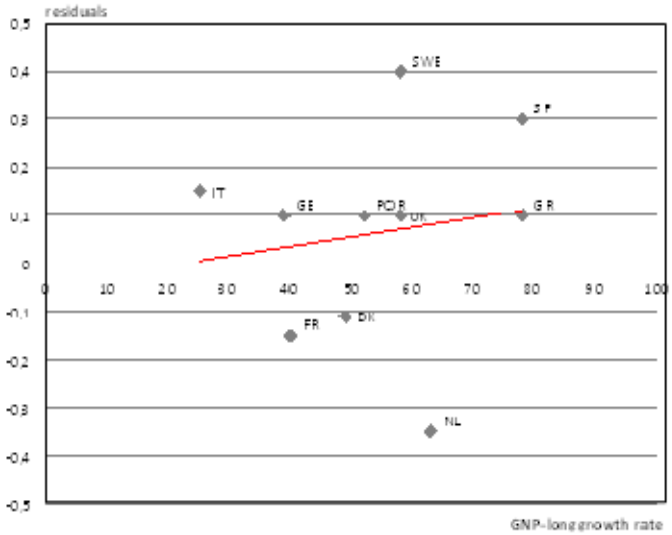

*Fig. 8 - Residuals of the YER/POP equation vs. GNP growth rate: y = - 0.05 + 0.002 x; R**2 = 0.12*

At first sight, long run GNP growth fails to explain the dynamics of youth employment even accounting for the impact exerted by the rise of school attainment.

There seems to be only one explanation left: inertia and persistence. Youth participation has very permanent features, much like other social phenomena to which I shall soon turn. Fig. 9 shows that the countries where youth employment was highest many years ago, are still firmly on top of the list, and the same holds for those that were at its bottom.

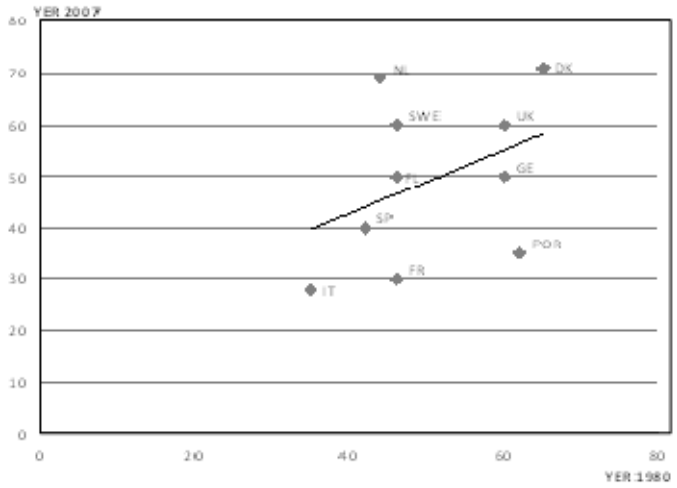

*Fig. 9 Inertia in youth employment: y = 21.6 + 0.61 x; R**2= 0.21*

2.3. Skill mismatch ?

Skill mismatch could have a role in the explanation of the poor performance of youth employment policies in Southern Europe. Unfortunately its existence is difficult to assess with the available macro-data. The positive correlation between the youth employment ratio 2007 (YER 2007) and the ratio of tertiary education attainment to population 2006 (fig.10) is not surprising and may hint at the possibility of mismatch, but certainly does not prove it.[9] On the other hand, the negative correlation between the rates of change of YER and SCH (fig. 6 above) should be interpreted as a natural and positive consequence of higher schooling attainment in countries where it was particularly low (IT and POR), rather than potential evidence against skill mismatch. It is possible that, given the rapid pace of technological change in the world as a whole and in the EU in particular, the education system does not allow a smooth transition of the young into the labor market, and so youth employment rates are still low where schooling attainment has rapidly increased (but the system may have not been sufficiently upgraded) and they are high where attainment has been high for many years.[10]

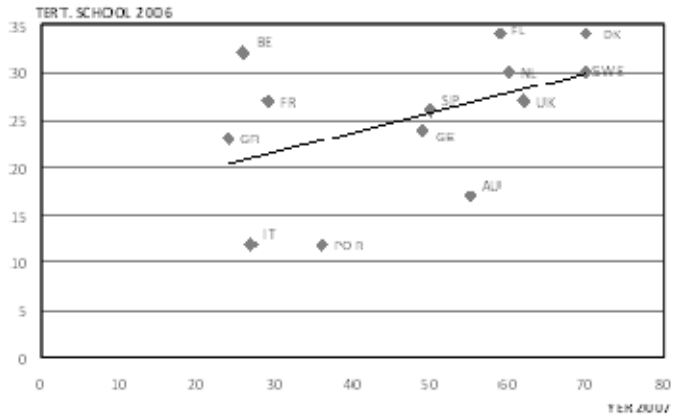

*Fig. 10 - Tertiary school attainment and youth employment: y = 16 + 0.24 x; R**2= 0.42**

2.4. Young workers: substitutes or complements?

The impact of demography and schooling on youth employment is, at this stage, fairly clear. The question that need be answered now is the extent to which there may be relations of complementarities and/or substitutability between young workers on one side, and women and old people on the other. Women's employment rates have rapidly increased also in Southern Europe where they

[9] An additional element pointing in the same direction is given by the ranking of HRST (High Research, Science and Technology) graduates as percentage of the population, where Italy, Portugal and Greece lag behind all the other European countries.

[10] We owe this point to an unknown referee.

were lagging behind; on the contrary, no systematic trend of old workers' employment has been in sight (fig.11). The latter occurred despite the constant reminder of the European institutions in favor of increasing the employability of the "young elderly": ageing and low participation imply future scenarios in which the economic dependency rate - the ratio of persons not in the labour force to those in the labour force - could become hardly sustainable: according to the OECD economic dependency rates will rise from average 60% in 2000 to 75% in 2050.

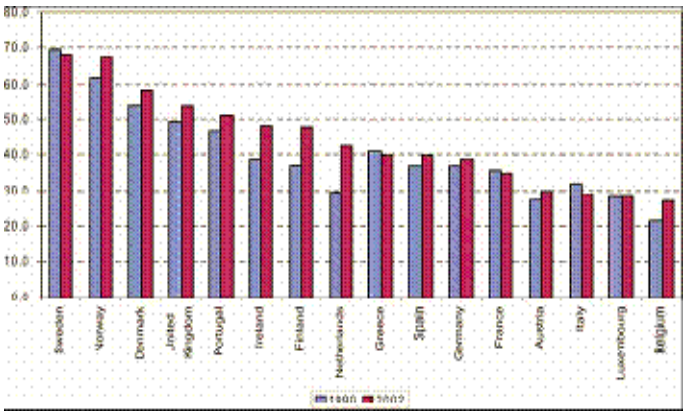

Fig. 11 Employment rates of elderly workers (60+)

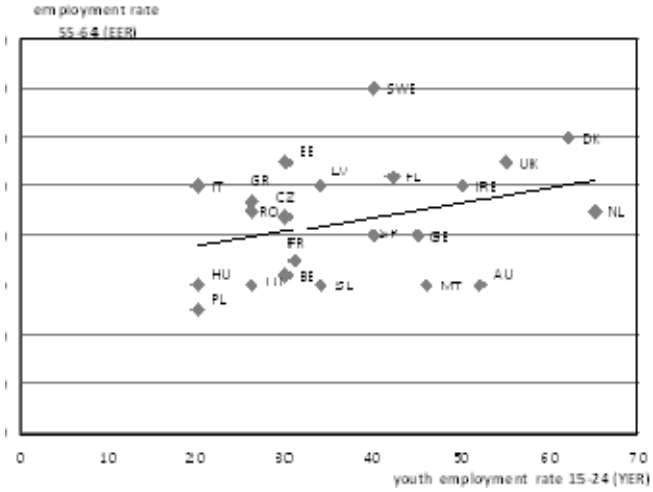

Fig. 12 Employment rates of young vs. old workers:
*y = 33.5 + 0.29 x; R**2 = 0.51**

The idea that elderly workers and young workers might be efficient substitutes was (and perhaps still is) deeply rooted. Early retirement was advocated by many policy makers in the Eighties and Nineties as a remedy to facilitate employment for the young. And it has often been the object of negotiation with the unions with the intent of making room for young entries. Empirical evidence by A. Kapteyn et al. (2008) does not support the hypothesis

and finds instead some minor complementarities, suggesting that discouraging early retirement will have no adverse effect on youth employment.[11] Nor did J. Gruber, K. Milligan and D. Wise (2009) find evidence of the claim that there is a fixed number of jobs into which the young will move when older workers retire. The scatter-plot of youth (15-24) vs. older (55+) worker employment rates (fig. 12) confirms the hypothesis of weak complementarity rather than substitutability, a likely result of the growth of the service economy where the need for long opening hours requires part-time positions often filled by young people still attending school as well as women of all ages and older people.

A similar question relates to the potential competition between women and youth. Female employment has risen at remarkable speed since the Eighties: less in the Scandinavian countries where it has been historically high, much more in the rest of Europe. To what extent have women crowded out young workers in this process? While the growth rates of female and youth employment are basically uncorrelated, current female and youth employment rates are highly positively correlated (fig. 13), suggesting that some substitution may have taken place as a consequence of the rapid contemporaneous growth of the service sectors. Here, the top performers (high on both counts) are, once again, Sweden, Denmark, Netherlands, UK, while the bottom ones are Greece, Italy, Belgium and France[12].

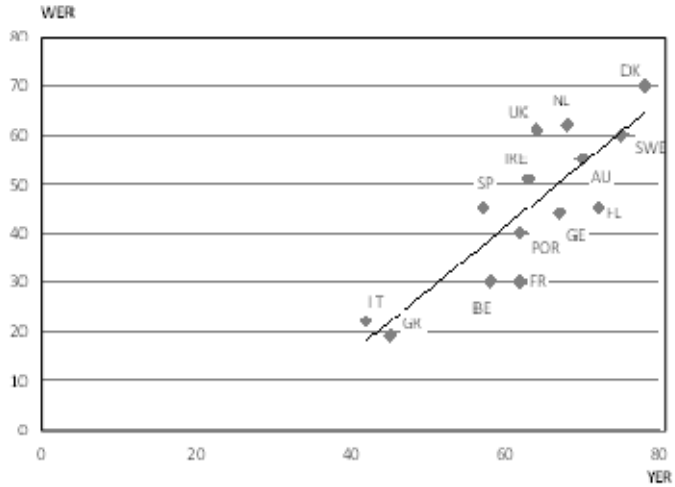

*Fig. 13 - Women and youth employment rates 2007: y = - 21.4 + 1.29 x; R**2= 0.79**

[11] A. Kapteyn, A. Kalwij, K. De Voos, "Early Retirement and Employment of the Young" RAND Working Paper Series WR- 679 estimate a dynamic model of employment of the young, prime age and old people using panel data of 22 OECD countries over the time period 1960-2004.

[12] It is worth noticing that similar associations hold also across Italy's 20 regions: higher employment rates of young people are positively correlated with both older people and women employment rates: top performers are regions of the North, the least performing those of the Mezzogiorno.

3. The role of institutional arrangements

Institutional arrangements have a crucial role in all the above developments. In this paragraph I show how existing institutional arrangements specific to the functioning of labor markets help to explain some of the cross-country differentials observed so far. A more general discussion of the interplay between institutions and performance is deferred to section 6.

Women's work is highly facilitated where institutions help the reconciliation of working time with family duties and child care. Likewise, older people may prolong their working life where: (i) wage costs are held in line with productivity; (ii) retirement options are flexible; (iii) good practices of age management are in place.[13] In this respect large differences exist, with the Scandinavian countries, Netherlands and France having achieved much higher standards than the rest of Europe. A rough but reasonable catch-all proxy of the extent of institutional involvement is provided by the share of social expenditure in GDP. Big social expenditure implies, *inter alia*, a relatively generous provision of child care, maternal leaves and old age care services, allowing women to participate to labor market activities which would otherwise be precluded by family chores. Fig. 14 shows a positive, although weak correlation between women's employment rate (WER) and social expenditure.[14]

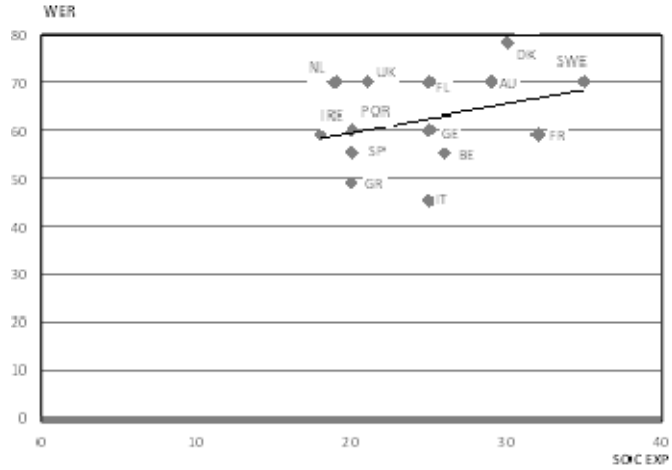

*Fig. 14 - Female employment and the share of social expenditure in GNP (2007); y = 52 + 0.59 x ; R**2 = 0.15*

[13] Good practices may take the form of flexible working times, reduced physically demanding tasks, retraining programs, redesigned workplaces and/or task rotation. In several countries of Northern Europe (Finland, Denmark, Sweden, Netherlands) public agencies provide advice and organizational consulting to firms willing to implement them (at times also limited financial benefits).

[14] In a few countries child care and domestic support aimed at helping women's work is provided directly by the employers: the leading country is the Netherlands with 41% of companies offering such services, followed by the UK with 17%, while in the rest of the European area such percentages are much lower, in the order of 2 to 7%.

More remarkable is the positive correlation between the share of expenditure on care for the elderly (% of GDP) and the employment rate of the elderly population (fig. 15).

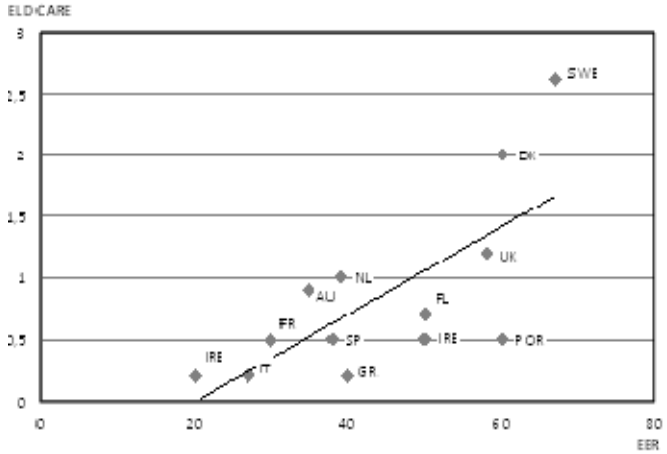

*Fig. 15 Expenditure on care for elderly and elderly employment rate 2007; y = - 0.85 + 0.035 x; R**2 = 0.53**

Insights on the employability of elderly people come also from studies on earnings mobility[15]: the employment rates of people 55+ are positively correlated with the probability of downward earnings mobility (fig. 16). Downward mobility may be an acceptable option towards the end of working life in the presence of efficient safety nets, namely a sound welfare state that provides for the elderly. Unless – as is the case of the U.S. and possibly other countries with very weak welfare systems – old people are forced to stay at work in order to make a living.

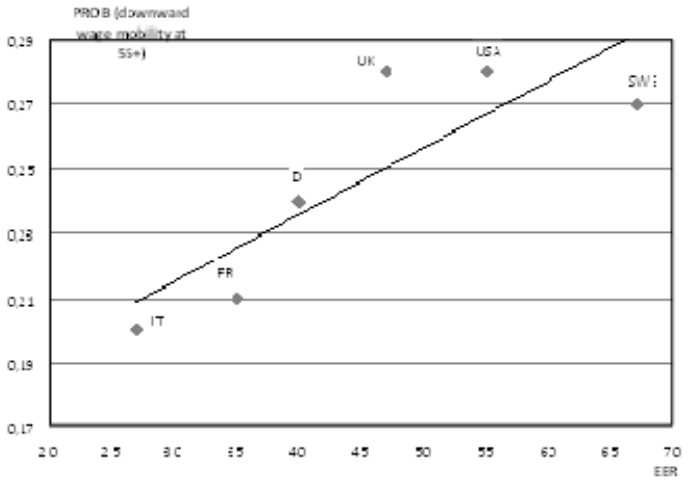

*Fig. 16 Wage mobility (1990-1999) and employment rates of 55+ (2002); y = 0.20 + 0.0021 x; R**2 = 0.56**

[15] B. Contini (2003). Earnings mobility relates to one's relative position in the wage distribution. A downward shift implies, for instance, that an individual who is in the 7-th decile of the distribution at year (t) recedes to the 5-th decile at (t+10).

Institutions appear also in the explanation of youth employment: in fig.17 youth employment rates are positively correlated with the share of ALMP expenditure in GNP. Here too Sweden and Denmark are the top performers, with Greece at the bottom of the list, and the UK as an interesting quasi-outlier.

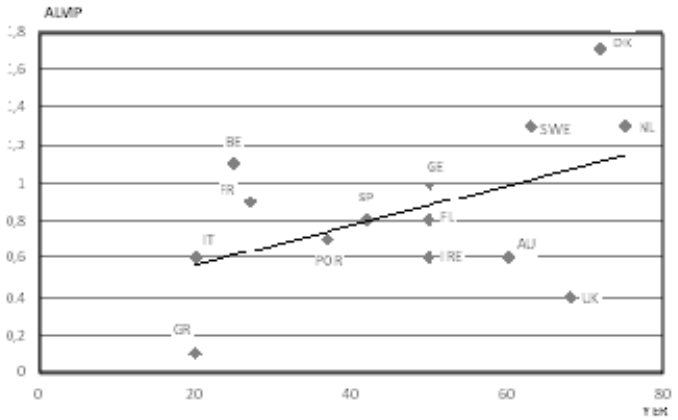

*Fig. 17 Youth employment rate 2007 and ALMP expenditure: y = 0.43 + 0.01 x; R**2 = 0.38**

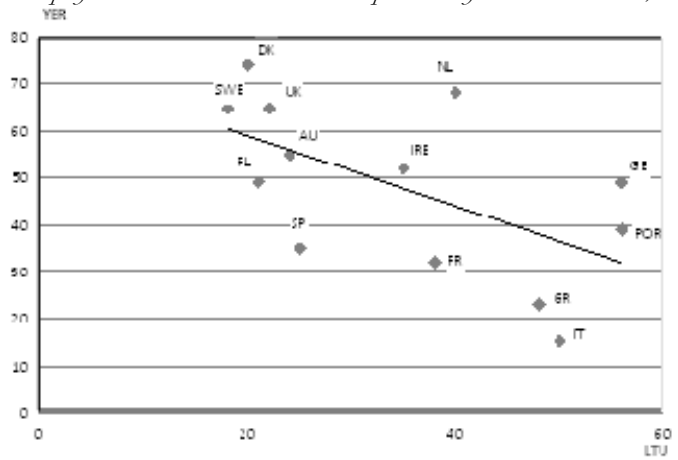

*Fig. 18 Youth employment (YER) and long duration unemployment rates (LTU) 2007: y = 78.2 - 0.75 x; R**2 = 0.49**

A well known stylized fact of EU labor markets is the tight negative association between long duration unemployment (12 months+) and youth employment (fig. 18). There is no obvious relation between the two, the explanation running, again, in terms of institutional arrangements. In the countries where many young people are at work, retraining programs and public labor exchanges are run efficiently, and not by chance. Turnover may be high and unemployment spells frequent. But spells are short as the young people who lose their job are helped to get quickly back to work. On the other hand, in countries with low youth employment, turnover may be equally high, while public employment services are less effective, thus prolonging unemployment duration. Youth employment rates in Sweden and Denmark are above 60% with the share of long-term unemployed at less than 20%. A long way down the opposite end stand Italy and Greece, with France and Portugal at short distance. A similar argument explains also the negative association between YER and youth

unemployment *tout court* (fig. 19): many of the long term unemployed are, in fact, young people.

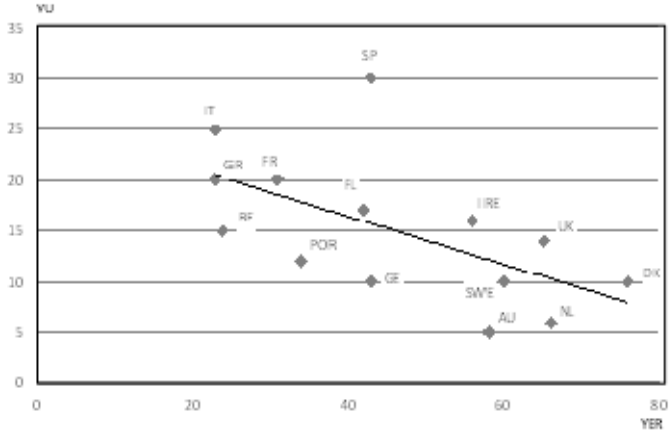

Fig. 19 - Youth unemployment and youth employment rates 2007:
*y = 24.4 – 0.24 x; R** = 0.42**

4. Wage rigidity and youth employment

The economists' classical explanation to the low employment rates of young people (and/or their high unemployment) is wage rigidity, and more specifically the failure of wages to adjust downwards. While measures of wage rigidity are not readily available (nor are minimum wages implemented in all EU countries), the ratio of adult wages to young people's wages provides an indicator of the relative cost of adult workers vis-à-vis their younger colleagues. The higher the relative cost of youth labor, the fewer the job offers to young people. Unfortunately it is impossible to single out how much of the differential is attributable to part-time and/or atypical jobs which are frequent among workers aged 15-24. With the above *caveats*, fig. 20 shows a slight positive correlation between youth employment rates and the relative cost of adult workers to their young counterparts (wage 35+ / wage 19-24), a weak match with theoretical predictions.[16] A different reading of the graph suggests that the well known divide between countries of Northern Europe (with Austria) with high YER in the upper part of the scatter and those of Southern Europe (with Belgium) with low YER, is proposed once again. Within each of the two groups of countries the expected positive correlation between YER and the adult/young wage differential emerges quite neatly.

[16] In the last decade the relative cost of adult vs. youth labor has increased in most of the EU, following the trend of rising wage differentials.

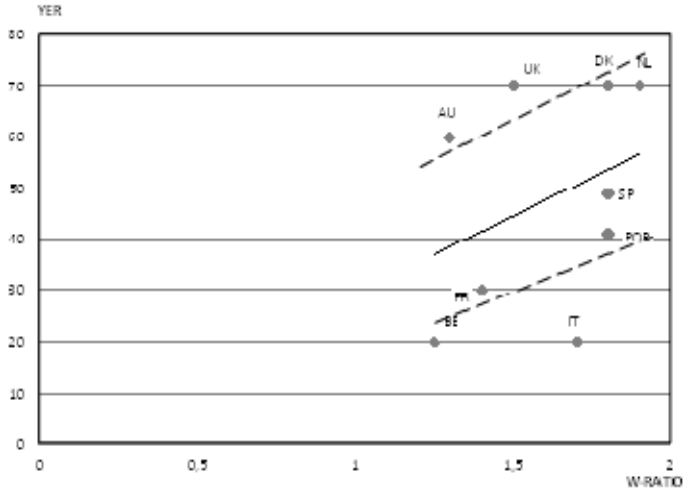

*Fig.20 Youth employment and the wage differential adult / young workers: y = 1.56 + 30.2 x; R**2= 0.16*

But two regression lines for each of the two clusters of countries are more meaningful.

5. Mobility and flexibility

In the previous paragraph I have argued that relative youth labor costs may, to some extent, contribute to explain youth employment differentials in Europe. Is there evidence that youth labor is also flexible and that such flexibility may also explain the improvement of youth employment prospects between the late Nineties and the beginning of the new millennium ? Flexibility refers to many different concepts: temporary jobs, fixed-term contracts, atypical positions, loose hiring and firing rules, disguised self-employment and others too. Each of these may have diverse meanings and implications in different countries. Measuring flexibility is a slippery problem.

Flexibility is sometimes proxied by indicators of mobility. Boeri and Garibaldi (2009) suggest that increased mobility may explain the youth unemployment decline in the EU via the increase in job finding rates and the reduction in unemployment compensations. Mobility is measured by the unemployment inflow and outflow rates for EU15 as a proportion of the relative population at risk. After peaking during the 1992-93 recession, unemployment inflows would seem to have stabilized at a significantly higher level than the rates registered in the late Eighties (fig. 21), while the outflows were steadily increasing. The argument is suggestive but somewhat weak in view of its aggregate nature.

A direct look at country data on flexibility of working contracts, provided by the OECD makes a better option at this stage. Caution is, however, necessary: as already pointed out, definitions of temporary and part-time jobs are not

homogeneous across countries, nor is it clear when the two overlap.[17] I resort to a rough proxy of atypical jobs: the weighted average between the share of temporary positions and that of part-time jobs (ATYP). Fig. 22 suggests an expected positive correlation between ATYP as defined above and the youth employment rate. The Netherlands stands out with the Nordic countries as resorting most frequently to atypical jobs for the younger cohorts. Spain follows at short distance: recall that in the mid 90's generalized time-determined contracts were introduced, but a few years after the applicability of the new contractual forms was drastically reduced. As a matter of fact, in 2008 Spain still tops the list with young people in temporary positions (OECD definition) with a share of 58.3% on overall employment, after having receded from 68.6% in 2000.

Do flexible workers enjoy being on flexible jobs? Fig. 23 shows a clear positive association between the share of young people working on temporary contracts against the share of young involuntary part-timers. The high correlation does not imply that the same people who hold temporary contracts are also part-timers against their will. It is a hint, however, of labor markets where large number of young people have reasons to complain. Not surprisingly Spain is at the top of this malaise (despite the previously mentioned counter-reform), while the UK and Ireland, the least regulated EU countries, are in best position, with a relatively small share of temp contracts and also a low incidence of young involuntary part-timers.

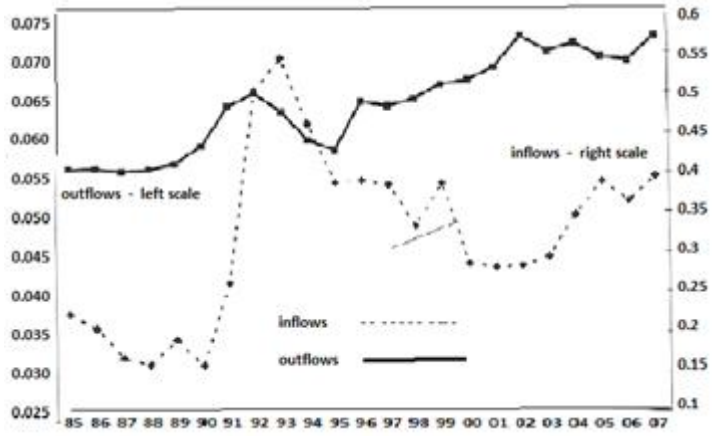

Fig. 21 Proxy unemployment inflows (as a percentage of employment) and outflows (as a percentage of unemployment). From: T. Boeri and P. Garibaldi, 2008. Estimates based on the OECD Unemployment Duration Database.

[17] The OECD data dealing with flexibility are the following: shares of temporary jobs and part-time jobs on total youth employment, of dependent workers with short tenure (less than 6 and 1 months), of involuntary part-timers among the young.

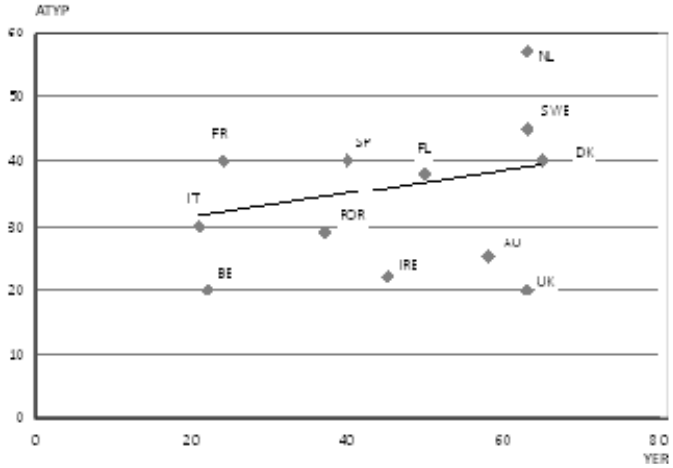

*Fig. 22 Youth employment vs. the share of atypical positions (ATYP). Year 2007: y = 28.7 + 0.18 x; R**2= 0.47**

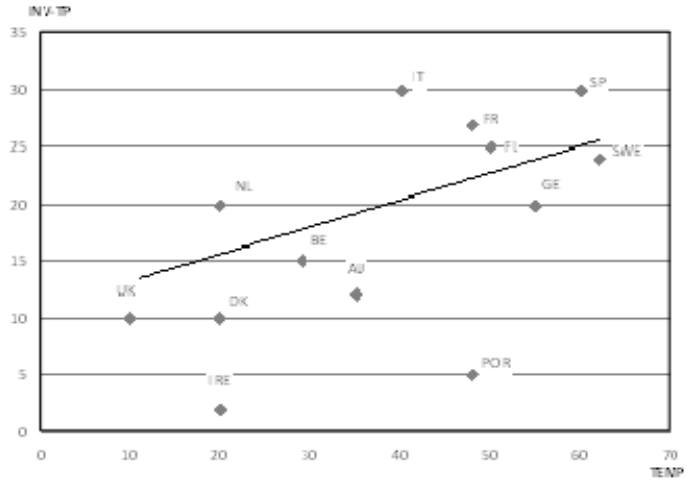

*Fig. 23 Temporary jobs and involuntary part-timers, 2005: y = 10.6 + 0.24 x; R**2 = 0.41**

6. Institutions, culture, social capital and performance

The considerations of the preceding pages are based on cross-country "between" comparisons that evoke patterns whose convergence is unclear and might take place only in the very long run. The categories of traditional neo-classical growth economics fall short of explaining the deep causes of such patterns by only focusing on differences in the paths of prices, factor accumulation, and technological progress.

Institutions are natural candidates for explaining the roots of long-run growth and performance. In his Nobel lecture D. North defined institutions as "… a set of rules, compliance procedures and moral and ethical behavior designed to constrain the behavior of individuals…": as such they shape the incentives in economic production and exchange. But the channels through which institutions affect economic activity are still largely unexplored. One problem is that economic institutions are endogenous: they influence the redistribution of resources, and therefore they are influenced by conflict of

interests and by political power. Undoubtedly the increasing unemployment during the Seventies and early Eighties led to changes in institutions as many EU governments tried to limit its rise. The literature has stressed the cross-country correlation between institutions and economic development (and I have here followed suit in relating the European institutions to labor market performance). But one of the issues is that of causality (Acemoglu et al., 2004), whose immediate consequence is the empirical problem of identification.[18]

An additional and basic aspect of the institutional context is the role of culture.

Culture touches upon several facets of lifestyles, which is not for me to explain. I will refer to two milestones that are responsible for some of the large differences of youth employment: the role of the family and that of social capital.

In the countries of the Mediterranean basin, the family notoriously acts as an economic clearing house for the young, the women and the elderly. Where young people live at their parents' home, whether because it simply makes life easier, or because the lack of job opportunities forces to do so, the youth employment rate are often lower. And, to the extent that young people do work, the percentage of those holding temporary working arrangements will be higher, as many count on additional resources generated within the family. Families mistrust public welfare and rely on own welfare, without paying taxes. Fig. 24 depicts the negative association between the percentage of young people (18-25) leaving with their parents and the youth employment rate. Fig. 25 shows a milder, although positive association between the share of youth living with their parents and the frequency of temporary jobs held by the age group 15-24. The causal relation between the two phenomena may obviously go both ways, and identification is a problem here as elsewhere. The two graphs are, however, highly suggestive of the association that links the role of the family with youth employment.

[18] The deep question is whether institutions are really exogenous or, instead, if they adjust to pre-existing trends, sanctioning and legitimizing their nature. in this sense, institutions may be truly endogenous.

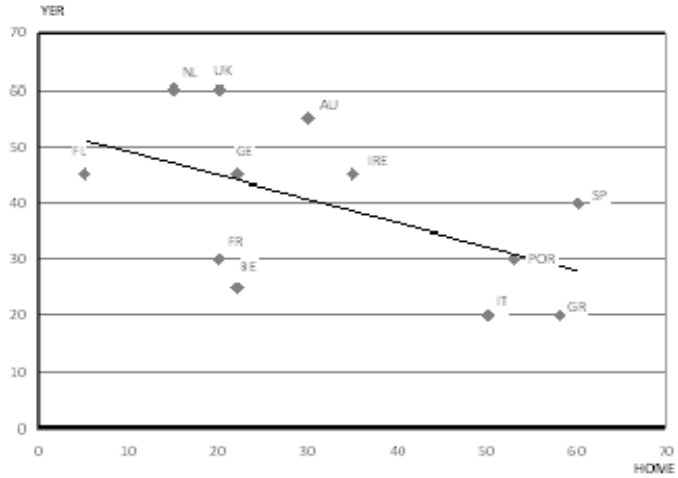

*Fig. 24 The family as an economic clearing house (1): youth employment rate and the share of young people leaving at parents' home: y = 52.8 – 0.43 x; R**2 = 0.56**

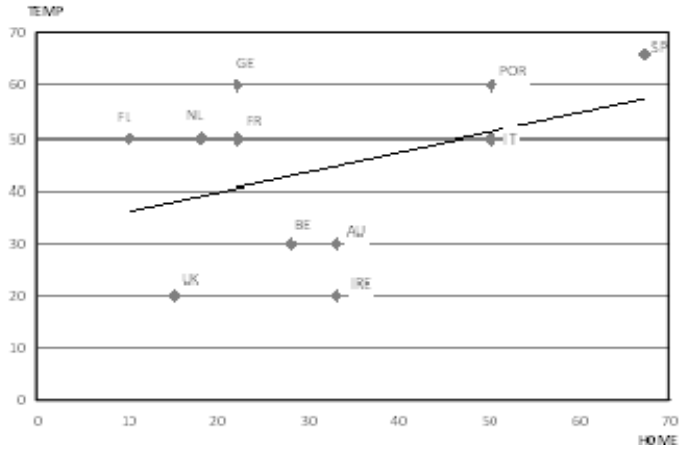

*Fig. 25 The family as an economic clearing house (2): shares of temporary jobs held by youth 15-24 and of young people leaving at parents' home: y = 33.7 + 0.37 x ; R**2= 0.42**

The second milestone is social capital, defined by the set of beliefs and values that facilitate cooperation among members of a community and provide informal rules of behavior (Guiso et al. 2004; Tabellini, 2010). These authors argue that social capital is at least as important as the formal rules embedded in institutions. As suggested by Algan and Cahuc (2007 and 2009), the flexicurity strategy advocated by the European institutions to deal with the future of youth employment is helpless unless these issues are taken into account. Building trust is a pre-requisite as well as a by-product of successful flexicurity approaches. But building trust is a long, indeed gigantic task. Tentative estimates of "trust" have been suggested using survey data like the Eurobarometer, those on job quality and well-being conducted by the European Foundation for the Improvement of Working Conditions, and also World Bank indicators. The "right amount of trust" has been the object of preliminary but very suggestive inquiry (Guiso et al. 2006): "….in one group, the high trust North European countries, such as Norway, Denmark, Finland, Sweden and the Netherlands, the distribution (of trust) has a fat tail on the right and the modal level of trust is quite high. In another group – the Mediterranean countries and several Eastern European

countries - the fat tail is t6o the left, denoting low average trust. In a third group including several EU countries (Austria, Germany, France and the UK) the distribution is more balanced with (intermediate) modal values…., and the distributions are more symmetric". This finding, which takes us back to G. Esping Andersen's classification of the Welfare States, is hardly surprising in the light of what I have argued in this paper. It closely matches all the rankings that have been so far reported.

The World Bank provides an annual survey "the rule of law" of 219 world countries ranked according to the compliance with their own legal system: each score indicates the country's percentile rank. At the bottom of the list are found most of the poorest countries of the globe. All European countries rank above the 80-th percentile (Norway and Denmark stand at the top of the distribution), with the remarkable exception of Italy and Greece. I have plotted the youth employment rates against the EU country scores (fig. 26): not surprisingly, a clear positive correlation between the two indicators emerges, with Italy and Greece lagging behind all other countries.[19] Here is another hint of how the institutions – via the rule of law - impact on labor market performance vis-à-vis the weakest fringes of the workforce: the young in first place, but also the women and the elderly. Compliance with the law, accountability, control of corruption, regulatory quality, all contribute to strengthen the credibility of the institutions and the confidence entrusted by the constituency.[20] Tax compliance is a natural economic indicator of such confidence : where tax evasion is high, the welfare state is weak. And a weak welfare system will fail to provide solid bases to the institutions that enhance the employability of the weak fringes of the workforce.

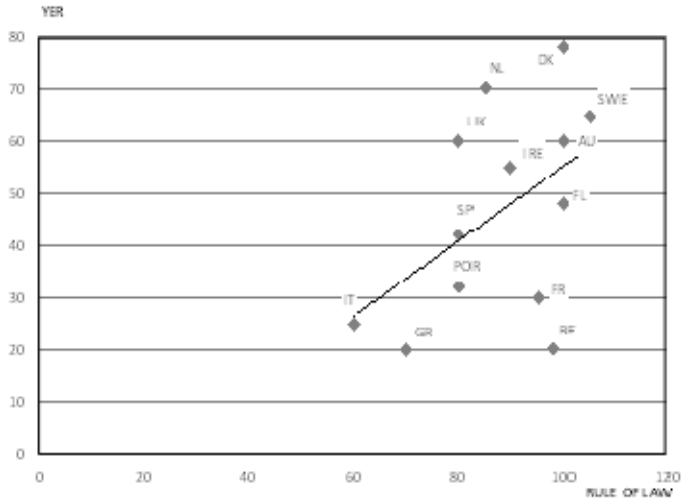

*Fig. 26 Youth employment rate (2007) vs. Rule of Law: y = - 12.3 + 0.71 x; R**2 = 0.60**

[19] As the jurists put it, the "law in the books" is quite a different matter from the "law in action".

[20] The World Bank provides annual indicators also on these related items of the Rule of the Law: Not surprisingly, all rankings are highly correlated.

The tax compliance –non compliance game has a similar structure to the prisoners' dilemma: each citizen faces the same payoff and is liable for the same tax. The cooperative solution will emerge only if all comply: the payoff is big and available to all in the form of benefits from the welfare state. But the individual incentive to free ride is large. Hence the cooperative solution is not a stable equilibrium. The non-cooperative and stable equilibrium of the game is for all to evade: as a consequence there will be no welfare system and the payoff is low for all. If the "rule of the law" is missing, the non-cooperative solution is doomed to prevail. The institutions can change the payoff structure by introducing appropriate sanctions and benefits, but this too may fail to restore the incentive to free ride. The only way by which the institutions may affect the outcome of the game is by restoring or building confidence altogether. If the effort is successful – but, as already pointed out, the task is gigantic - the incentive to play non-cooperatively may decrease to the point where the cooperative solution becomes viable.

In the Mediterranean countries of the EU the irregular (black, unofficial) economy has traditionally been large, a consequence of economies where small firms play a major role, self-employment is high, open and disguised unemployment big, and, most of all, tax evasion is pervasive and sanctions rarely implemented. Where labor markets are deregulated (mainly English speaking countries: UK, IRE, US, AUS, NZ, but also DK), nearly all jobs held by young people (waiters, shop clerks, occasional jobs in the personal service sectors, seasonal jobs in agriculture) are "regular" and will normally be reported in LFS-type surveys. In Southern Europe, instead, the incentive not to report is much stronger.[21]

The negative correlation between the size of the irregular economy and the rule of law is evident and self-explanatory (fig. 27). The negative correlation between the size of the irregular economy and the protagonist of our story, the youth employment rate (fig. 28) is a consequence of the above, but deserves to be discussed in its own right. Many young people, national or migrants – for that matter not only young people - who find it hard to find a job in the regular economy, will easily be attracted in the area of black or grey activities where the rule of law is weak. In the irregular economy pay is low and job security inexistent, the border line between legality and illegality is frail and dangerous (but earnings may be high in the world of outright criminal activities). Nor will these individuals report to have a job to the LFS interviewers.[22] If retraining

[21] Previous explorations (Contini and Grand, 2010) suggest that if youth unemployment in Italy were calculated including most of the irregular jobs (waiters, shop clerks, baby-sitters, seasonal jobs in the agricultural sector, etc.), it might fall by 6-7 p.p., down to 13-14% from the official count of 20%, much more in line with countries of Central and Northern Europe.

[22] In the poorest neighborhoods of Naples estimated youth unemployment is close to 40%, with the extent of the black economy also known to be at its highest. In the banlieus of Paris the situation may not be very different.

programs and public labor exchanges were run efficiently unemployment benefits and/or safety nets of some sort available, the institutions would gain credibility and youth employment rates might not look as bad as they do. This is not a defense of the black economies, nor does this imply that illegal activities are a beneficial and effective safety valve against overt unemployment and high poverty. They are, in fact, a sort of safety valve that relieves from "private" poverty at outrageous risk (of life for those in criminal activities like the mafia, but also for those employed in many activities - illegal construction is the most obvious - where the most elementary safety measures may be absent), and disastrous from a collective perspective: profound distrust for the institutions and distance from democratic values, sheer illegality in all aspects of life, no incentives to education, tax evasion, obstacles to free economic competition and technological change. From this perspective it is disappointingly easy to conclude that the negative macroeconomic performance of Spain and Italy presented at the beginning of this paper is a consequence of such perverse dynamics, and not at all its cause.

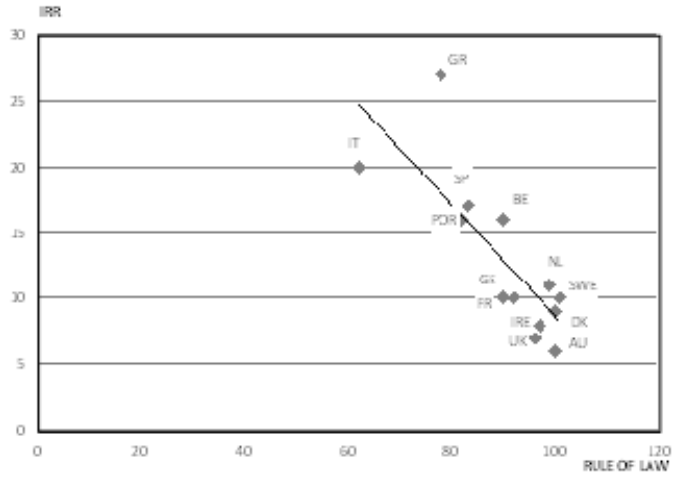

Fig. 27 - The size of the irregular economy and the Rule of Law:
*y = 50.4 – 0.42 x; R**2= 0.44**

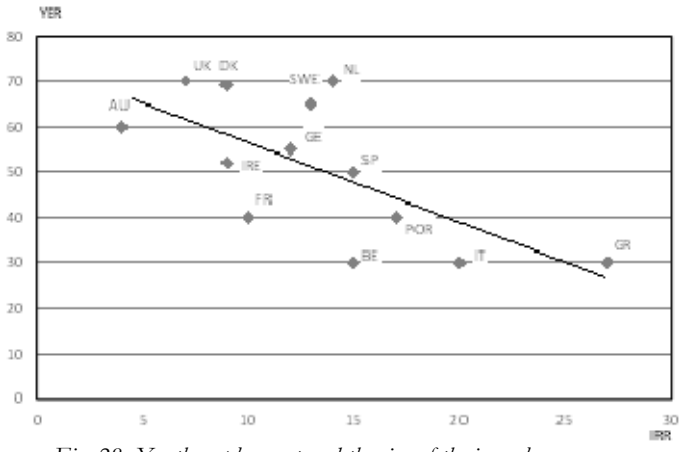

Fig. 28- Youth employment and the size of the irregular economy:
*y = 72.5 – 1.74 x; R**2 = 0.51**

7. Conclusion

Does this exploration suggest policy measures that may have an impact on youth employment in countries (especially of Southern Europe) where it looks most problematic? And where they might exert such impact in somewhat less than biblical times? The European Union has had youth employment on the agenda for at least two decades, but the impact of a variety of policy recommendations has been, at best, modest. Authoritative economists have acknowledged that employment policies for the young have been much less than successful. O. Blanchard has recently (2006) asked a courageous question "do we know enough to give advise ?". My own modest answer cannot be but disappointingly negative: we are dealing with persistent and structural patterns, difficult to reverse without drastic reforms of the fiscal system *in primis*, of the labor market and of the welfare institutions as natural seconds. Not just reforms at the margin, as many that have been implemented for decades. Drastic reforms, however, need constituencies that will strongly support them. Unfortunately, very few are in sight, especially as of today, early 2012, at the eve of decisions that ought to change the future of the European Union in the direction of a much stronger political unification. A reversal of demographic trends, the not-so-distant retirement of the baby boom generation and a successful, although very difficult, integration of immigration flows, may lead in the right direction if accompanied by intelligent and very forward looking policies.

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Glossary

YDR = youth dependency ratio = youth population(age 15-24) / population in working age (15-65)

YER = youth employment rate (age 16-24)

SCH = % attainment of secondary education on 15-24 age group

WER =women employment rate 2007

EER = elderly employment rate (55 +) in 2007

ALMP = % active labor market programs on GNP

LTU = long term unemployment rate (12 months +)

YU = youth unemployment rate (15-24)

ATYP = share of temporary and/or part-time jobs on employment (2007)

IRR = share of irregular employment activities on labor force (early 2000's)

SOC-EXP = share of social expenditure on GNP (2007)

ELD-CARE = share of spcial expenditure on elderly care on GNP (2007)

W-RATIO = wage ratio <adults 35+ / youth (18-24) >

INV-PT = % of involuntary part-timers on all part-timers (2007)

TEMP = % of temporary workers on youth employment (2007)

HOME = % of youth employment living at parents' home (2006)