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Tackling the youth employment crisis: A macroeconomic perspective

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Preface

The primary goal of the ILO is to contribute, with member States, to achieve full and productive employment and decent work for all, including women and young people, a goal embedded in the ILO Declaration 2008 on *Social Justice for a Fair Globalization, and*[1] which has now been widely adopted by the international community.

In order to support member States and the social partners to reach the goal, the ILO pursues a Decent Work Agenda which comprises four interrelated areas: Respect for fundamental worker's rights and international labour standards, employment promotion, social protection and social dialogue. Explanations of this integrated approach and related challenges are contained in a number of key documents: in those explaining and elaborating the concept of decent work[2], in the Employment Policy Convention, 1964 (No. 122), and in the Global Employment Agenda.

The Global Employment Agenda was developed by the ILO through tripartite consensus of its Governing Body's Employment and Social Policy Committee. Since its adoption in 2003 it has been further articulated and made more operational and today it constitutes the basic framework through which the ILO pursues the objective of placing employment at the centre of economic and social policies.[3]

The Employment Sector is fully engaged in the implementation of the Global Employment Agenda, and is doing so through a large range of technical support and capacity building activities, advisory services and policy research. As part of its research and publications programme, the Employment Sector promotes knowledge-generation around key policy issues and topics conforming to the core elements of the Global Employment Agenda and the Decent Work Agenda. The Sector's publications consist of books, monographs, working papers, employment reports and policy briefs.[4]

The *Employment Working Papers* series is designed to disseminate the main findings of research initiatives undertaken by the various departments and programmes of the Sector. The working papers are intended to encourage exchange of ideas and to stimulate debate. The views expressed are the responsibility of the author(s) and do not necessarily represent those of the ILO

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[1] See http://www.ilo.org/public/english/bureau/dgo/download/dg_announce_en.pdf

[2] See the successive Reports of the Director-General to the International Labour Conference: *Decent work* (1999); *Reducing the decent work deficit: A global challenge* (2001); *Working out of poverty* (2003).

[3] See http://www.ilo.org/gea. And in particular: *Implementing the Global Employment Agenda: Employment strategies in support of decent work, "Vision" document*, ILO, 2006.

[4] See http://www.ilo.org/employment.

Foreword

This paper is a revised and substantially expanded version of a background note that was prepared for the report on the *Youth Employment Crisis: Time for Action* that will be presented and deliberated at the 101st session of the International Labour Conference (1 - 14 June 2012). The authors highlight salient empirical regularities. First, the youth unemployment rate is typically twice the adult unemployment across low, middle and high-income countries. Second, youth employment is much more sensitive to business cycles and policy-induced economic downturns than adult employment. Third, short-run demand shocks mutate into long-run 'scarring' effects manifested in reduced employment and earnings opportunities that can last decades. Young people with limited skills and from disadvantaged backgrounds are particularly vulnerable to 'scarring' effects. There are also well-known negative externalities associated with high and persistent youth unemployment: higher incidence of unhappiness, higher crime rates, higher inequality, higher fiscal costs in terms of foregone output and lower tax revenues, and higher political and social tensions.

The authors draw on these stark and stylized facts to suggest that recent macroeconomic events, most notably the global financial and economic crisis of 2007-2009 and the contentious fiscal austerity programmes that are particularly evident in the EU, have had rather adverse consequences on employment opportunities for young men and women. The authors note that many prominent economists have joined long-standing critics of fiscal policy in the advanced economies to argue the case for a gradual approach to fiscal consolidation and to urge policy-makers to make a greater commitment to growth-oriented policies.

The authors also provide a long-run and cross-country perspective on the drivers of youth employment. Here, there is a perennial debate between those who contend that a skills mismatch and onerous labour market regulations primarily inhibit employment opportunities for young people and those who contend that lack of labour demand reflected in the pace, volatility and pattern of growth is key to understanding the challenges facing the youth labour market. The available evidence points in the direction of the lack of labour demand as a binding constraint on youth employment, although skills mismatch and insufficient labour market flexibility are also relevant.

The authors make specific policy recommendations directed towards macroeconomic policy managers. There is a supply-side bias in policy design that needs to be rectified. Central bankers and finance ministries can aid and abet young job-seekers by alleviating binding constraints on the growth of private sector. This will entail promoting an agenda of financial inclusion, investing in infrastructure and boosting spending on labour market policies that can be accomplished at moderate cost (measured as a proportion of GDP). The exchange rate also emerges as a crucial policy variable that can facilitate structural transformation and expand productive employment opportunities. Lack of control over the exchange rate can be a debilitating impediment as members of the Eurozone have found to their cost.

One hopes that readers will find this working paper stimulating and thought-provoking and that it will encourage much-needed debate on crafting appropriate macroeconomic policy responses to tackling the youth employment crisis.

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1. Introduction: A scarred generation

The recent global financial and economic crisis of 2007-2009, the politically contentious and contractionary nature of the fiscal austerity programmes in the Eurozone and the UK and the recent uprising in some Arab states have reinforced policy interest in tackling youth employment and unemployment. [5] Historically, 'young people have always had a tough time finding work' (Morsy, 2012:15). What is perhaps less well known, especially among a non-specialist audience, is that young people can suffer from a long-run 'scarring effect' if they do not participate in a smooth transition to the labour market. When the economy is going through a downturn, as it did in the recent crisis, young men and women find it particularly hard to find or retain a job because of their relative lack of experience in the labour market. Such joblessness is not directly due to the ability or the willingness of young people to work. Yet, joblessness at an early stage in life of work can negatively affect the youth's long-run earning prospects and job opportunities.

Several studies have shown that those who experience unemployment early in their life are more likely to suffer subsequent spells of unemployment (among others, Morsy, 2012; Bell and Blanchflower, 2009). Earnings are also adversely affected. Oreopoulos et al. (2010) finds that students graduating in a recession commence work with lower paying employers and only gradually manage to make the transition towards better paying firms. Evidence shows that negative wage effects persist for more than a decade (for example, Genda et al., 2010; Khan, 2009). High youth unemployment is also associated with higher incidence of unhappiness and mental health problems as well as increased incidence of burglary, theft and drug offences (Bell and Blanchflower, 2009).

There is a positive correlation between poor youth employment outcomes and inequality. Morsy (2012) claims that rising youth unemployment in recent years has increased inequality (measured by the Gini coefficient) by 4 percentage points in all advanced countries and by as much as 8 percentage points in Greece, Ireland, Italy, Portugal and Spain. These are the countries that have been hard hit by the global economic and financial crisis of 2007-2009 and are mired in slow growth and recessions.

High and persistent youth unemployment can also impose significant costs on national budgets due to loss of output and tax revenues engendered by underutilization of human resources. A landmark report on youth unemployment in the UK claims that the 'net present value of the cost to the Treasury, even looking only a decade ahead, is approximately 28 billion (GBP)' (The ACEVO Commission on Youth Unemployment, 2012:4).

Lack of employment opportunities for young people can easily become a major source of political and social unrest as recent developments in the Middle East and North Africa have demonstrated. In the Eurozone, notably in countries such as Greece and Spain, which now have some of the highest youth unemployment rates in the world, social unrest and political tensions have become quite conspicuous.

[5] Youth labour force refers to those aged between 15 and 24. Adult labour force refers to those aged 25 years and above. Youth labour market outcomes in this report are mainly captured by unemployment rates and employment-to-population ratios. Other relevant outcome measurements for the youth labour market, such as incidence of those neither in education nor in employment or training (NEET), wages, contractual status, to name a few, are not analyzed. This is mainly because of serious data constraints for developing countries from secondary data sources; and for high income countries, analyses are done extensively elsewhere. For example, see OECD (2008).

In light of the grim spectre of a scarred generation and the negative externalities associated with poor youth labour market outcomes (unhappiness, crime, inequality, negative impact on national budgets, political instability), it is important to have a deeper comprehension of the drivers of poor youth employment outcomes. Such comprehension, based on a robust evaluation of available experience and evidence, enables appropriate policy action on multiple fronts to be undertaken in order to enhance durable and productive employment opportunities for young people. The paper seeks to make a modest contribution to that objective. In particular, the aim of the current paper is to clarify and explore the impact of the macroeconomic policy environment on youth labour market outcomes vis-à-vis other structural and supply-side factors. Such analyses will enable governments and social partners in ILO member states to ascertain the extent to which changes in the macroeconomic policy environment can improve employment outcomes for young people.

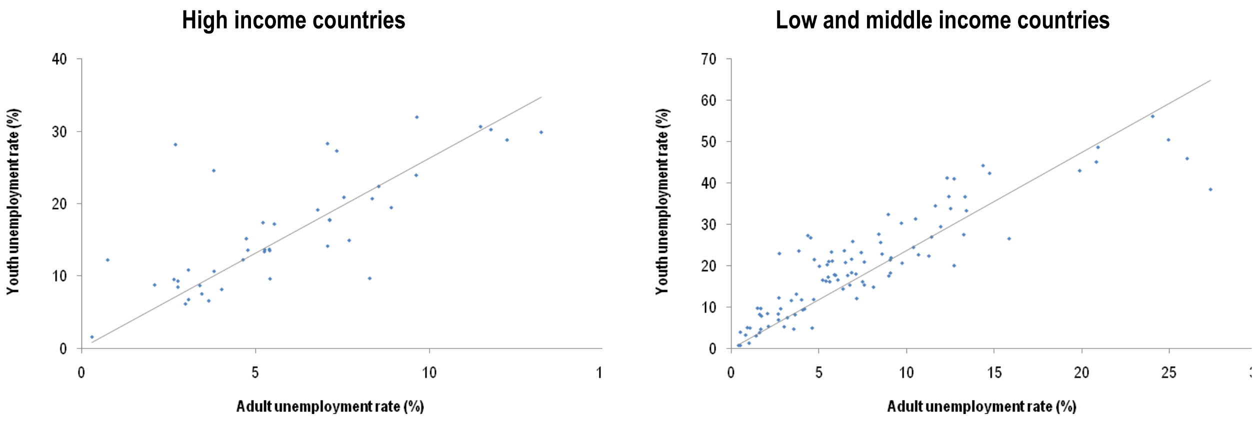
The paper is structured as follows. Section 2 examines the impact and implications of two major macroeconomic events: (a) the global financial and economic crisis of 2007-2009, and (b) the contentious fiscal austerity programmes in the Eurozone and the UK that commenced between 2009 and 2010 and persists today. The evaluation presented here suggests that a case can be made for reviewing the fiscal austerity measures given their contractionary consequences and adverse implications for the youth labour market. Section 3 interprets the drivers of youth employment outcomes from a long-run and cross-country perspective. Here, the perennial debate seems to be between those who subscribe to a structural, supply-side view of youth employment stemming from concerns about lack of appropriate skills and onerous labour market regulations and those who see lack of labour demand caused by the prevailing pace, volatility and pattern of growth as key determinants of poor youth employment outcomes. The evidence assembled here suggests that, while supply-side factors are certainly relevant, demand-side factors have a potent influence on the employment opportunities for young men and women. This is corroborated by evidence from enterprise-level surveys in Section 4 that shows the typical binding constraints on the growth of the private sector. Such binding constraints are compatible with a demand-side interpretation of youth employment. Sections 5 and 6 focus on specific policy issues. Section 5 highlights the fiscal implications of labour market policies. They can be implemented at moderate cost (measured as a proportion of GDP). They seem to be quite effective in normal periods of growth. Hence, low and middle income countries can boost spending on labour market policies at moderate costs and expect to reap some dividends. Section 6 highlights the important role that the exchange rate regime plays in facilitating structural transformation and expanding employment opportunities both for young people and their prime-age counterparts. In particular, the lack of control over the exchange rate can turn out to be a debilitating impediment, especially during downturns, as the Eurozone economies have found to their cost. Section 7 offers a conclusion by summarizing key findings and reiterating the key policy messages.

2. The youth employment crisis: The impact and implications of recent macroeconomic events

This section briefly reviews the impact on the youth labour market of two major macroeconomic events: (a) the global financial and economic crisis of 2007-2009, and (b) the contentious fiscal austerity programmes in the Eurozone and the UK that commenced between 2009 and 2010 and persist today. Two key findings emerge from the discussion. First, regions and countries that were badly hit by the crisis of 2007-2009 were, in general, also the ones in which the youth unemployment rose steeply and youth employment fell sharply. Second, the fiscal austerity programmes that have been implemented since 2010 appear to be associated with significant contractions in GDP growth. Indeed, both the Eurozone and the UK are in the throes of a 'double dip' recession. One can make the plausible conjecture that the corresponding changes in youth employment outcomes will be rather adverse over 2012 and beyond – a view that has been corroborated by media reports.

The discussion commences with a review of well-known empirical regularities. First, there is a strong correlation between youth unemployment and adult unemployment. The former is usually twice that of the latter (see Figure 1). At the same time, youth unemployment is usually more sensitive to business cycles than adult unemployment rates. This is captured in Figure 2 which compares the period from 2005 to 2007 to the period of crisis and slow recovery of 2008 to 2010. As can be seen, in the hard hit developed world, and especially the EU, the youth unemployment rate increased by 2.9 percentage points while the adult unemployment rate increased by 1.2 percentage points. The developing world in general did not suffer an outright recession during 2008-2009 and recovered quickly from the growth deceleration – which perhaps explains why the youth unemployment rate declined at a faster pace than the adult unemployment rate over the relevant time period in some developing regions (Majid, 2011).

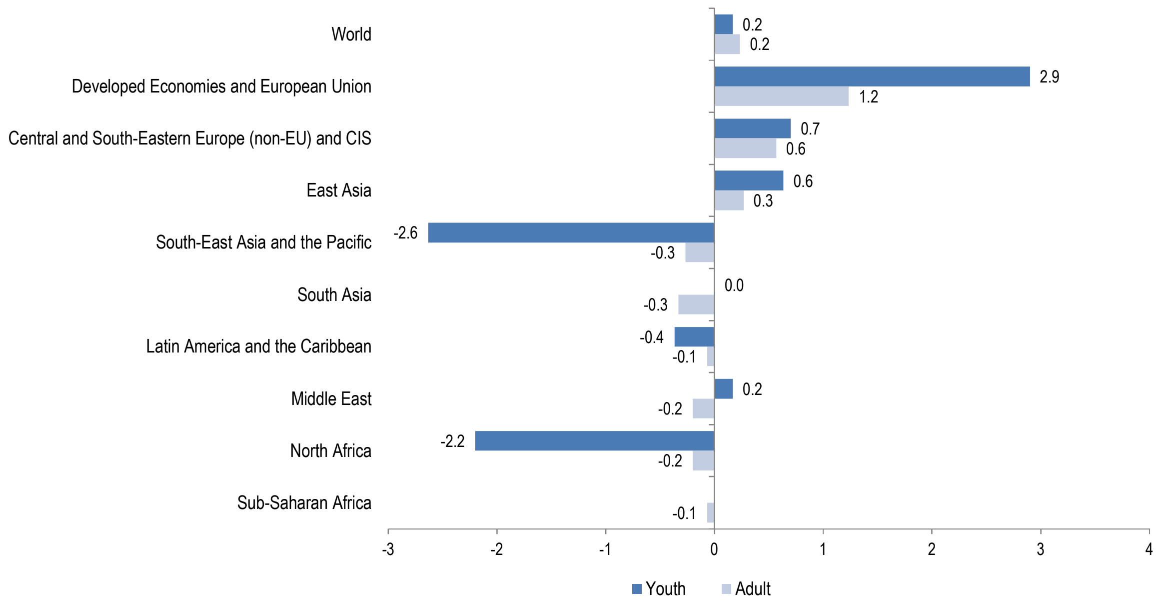
Figure 1. Youth and adult unemployment rates, country-level averages for 1990-2010



Source: ILO (2011b).

Note: Following country income classification by the World Bank, the sample consists of 43 high income countries and 99 low and middle income countries.

Figure 2. Before and after the crisis: Percentage point changes in youth and adult unemployment rates



Source: ILO (2011b).

Note: The figures represent percentage point differences between 2005-2007 and 2008-2010 period average unemployment rates for youth and adults.

A more detailed examination of the labour market outcomes of young men and women (15-24 years) vis-à-vis prime age men and women (25-64) in the EU (27 member states) also corroborates the higher cyclical sensitivity of youth employment. For example, between the third quarter of 2008 and the third quarter of 2009, in the EU as a whole, employment declined by 10 percentage points for young men and by about 7 percentage points for young women. The corresponding statistics are just over 2 percentage points for prime age men and well below 1 percentage point for prime age women (Verick, 2011).

Consider now the contentious issue of fiscal austerity programmes that have taken hold in more than 90 per cent of the advanced economies since 2009. This fiscal retrenchment is particularly pronounced in the Eurozone and the UK. It was triggered by the belief that the rich world faced an unsustainable increase in public debt following the implementation of the stimulus packages to cope with the negative aggregate demand shock unleashed by the global economic and financial crisis of 2007-2009. At the time, those who advocated the fiscal austerity programmes argued in favour of bold and decisive action in terms of spending cuts and tax adjustments on the ground that the historical evidence shows a positive association between fiscal austerity and output expansion. Hence, the belief was that kick-starting growth in the EU and other parts of the rich world require boosting 'market confidence' that would spur investment and create jobs. This was best achieved, went the argument, through 'front-loaded' fiscal austerity programmes.[6]

More than two years have elapsed since the start of this experiment and the outcomes have unfortunately not been friendly to the cause of fiscal austerity advocates or 'austerians' as they have sometimes been called. There is a significant correlation between the general government structural (or cyclically adjusted) fiscal balance and the contraction

[6] See Islam and Chowdhury (2012, 2010) for a review of the issues and evidence pertaining to fiscal austerity and growth.

in GDP (Figure A.1 in the Appendix). Those countries with the highest changes in structural balance in the EU have also been the ones with the highest contraction in GDP. Simple regression estimates show that a one percentage point increase in fiscal tightening would lower average GDP growth by 0.5 percentage points. Unsurprisingly, the imposition of austerity measures also entails severe consequences for youth labour market outcomes. As illustrated in Figure 3, the increase in youth unemployment between 2009 and 2011 tends to be higher for economies which have undergone strong fiscal tightening; a one percentage point increase in structural balance is estimated to significantly raise the youth unemployment rate by 1.5 percentage points.

More elaborate macroeconometric models suggest that the fiscal entrenchments will be associated with negative employment growth of the order of 0.2 per cent over the medium term (ILO and IILS, 2012). This is in line with the standard Keynesian dictum that fiscal consolidations are contractionary and becomes even more so when actual output is below potential output. This was certainly the case for the Eurozone and the UK given that the tepid recovery which emerged after the global economic and financial crisis of 2007-2009 did not have sufficient time to take hold as there was a decisive switch from fiscal stimulus to consolidation between 2009 and 2010. Of course, these contractionary consequences can be offset by expansionary monetary policy and exchange rate devaluations. Yet, members of the Eurozone do not have an independent exchange rate policy, nor do they have independent monetary policy. In any case, monetary policy even outside the EU, such as in USA and Japan, are stuck in a 'zero lower bound', that is, the policy rate cannot go down below zero. Hence, the contractionary consequences of fiscal policy have become painfully evident. Unfortunately, as Figure 3 shows, young people will become major victims with a high risk of 'scarring effects'.[7]

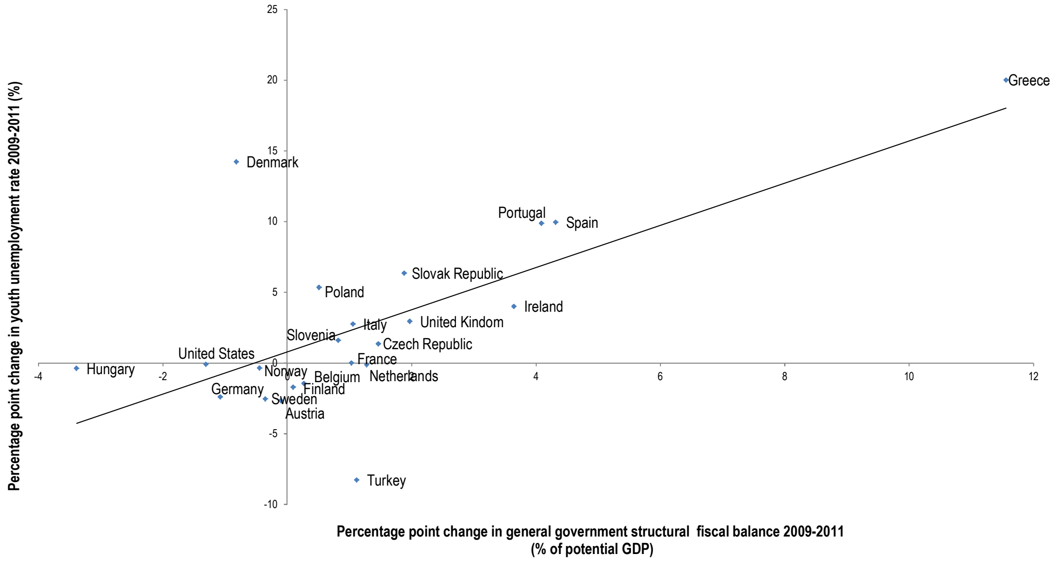
Calls are now being made by prominent economists and media commentators – along with long-standing critics of fiscal policy in the EU and advanced economies in general – that governments, most notably the Eurozone and UK, should change course, especially in light of growing concerns about the political and social sustainability of fiscal austerity programmes in the rich world. Policy-makers should go for a gradual approach to fiscal consolidation and find fiscally neutral ways in which targeted interventions towards job creation for young people can be supported.[8] Given that individual member states do not have control over monetary and exchange rate policies, the ECB and countries with fiscal space are being urged to make a greater commitment to growth at the EU level. Hence, the ECB could be more pro-active in its 'quantitative easing' programme. Its aim to inject

[7] For the United States, Kahn (2009) finds that 15 years after graduation, the wage loss arising from entering the labour market during a recession amounts to 2.5 per cent and is still statistically significant. Genda et al. (2010) compares unemployment rates at the point of entry and contemporaneous unemployment rates between Japan and the United States between 1983 and 2003. The study finds that the school-based hiring system for high school graduates in Japan, combined with labour market entry during recession, is associated with higher likelihood of non-employment and part-time employment, translating into persistent negative effect on earnings.

[8] Krugman (2012), Romer (2012a, 2012b), Summers (2012), Weisbrot and Montecino (2012), and Wolf (2012) have consistently criticized the stance of fiscal policy in the advanced economies in general and the EU in particular. Romer (op.cit) notes that successful cases of 'back-loaded' fiscal consolidation can be found in the experiences of the USA, Sweden and Australia during the 1990s. An example of a fiscally neutral intervention to assist young people find jobs is to make it mandatory for public sector organisations to hire long-term unemployed young workers for, say, two years, and spend an equivalent of the unemployment and job search benefits that would be spent on them. This will transform the role of government as a provider of unemployment and job search benefits to an employer of last resort.

liquidity in the banking system has avoided a systemic banking collapse, but it could purchase bonds directly from debt-distressed economies in the EU and thus reduce borrowing costs. This can provide crucial breathing space for these economies to engage in targeted interventions to promote growth and expand job opportunities for young people. Net creditors in the EU could engage in more expansionary fiscal policy and support a generous scheme of low conditionality fiscal transfers to debt-afflicted economies in the EU (see, for example, Grauwe (2011).

Figure 3. Fiscal tightening and youth unemployment across selected OECD countries



Source: OECD (2012b) for youth unemployment rates 2009-2010; Eurostat (2012) for youth unemployment rates 2011; and Economy Watch (2012) for general government structural fiscal balance (% of potential GDP).

Note: Correlation coefficient = 0.69; R^2 = 0.47.

3. A long-run and cross-country perspective on the drivers of poor youth employment outcomes: Issues and evidence

There is a perennial debate on the causes of poor youth employment outcomes that transcends current concerns about the deleterious consequences of recent and contemporary macroeconomic events. Beyond cyclical fluctuations, are youth facing difficult entry into the labour market due to a sustained shortfall in demand that spans over many years, caused by the pace and pattern of growth? Are they due to supply-side and structural factors manifested in a skills deficit and skills mismatch? Or are they primarily due to insufficient labour market flexibility that penalizes young entrants to the workforce because they face institutional barriers to access jobs, especially of a regular type?

Explaining youth labour market outcomes by skills and educational attainment has perhaps been the most popular approach by analysts and policymakers, including the international organizations, as they are seen to be 'treatable' by appropriate policy responses.[9] The same can be said for labour market flexibility: it seems fairly straightforward, but not necessarily easy, to change a piece of legislation or remove an institution. What is much more elusive to policymakers is how to generate new jobs that are of desirable quality. The discussion in this and subsequent sub-sections reviews the pertinent evidence on the different approaches to youth labour market analysis. The main argument put forth is that a shortfall in labour demand, cyclical and structural, caused by the pace and pattern of growth is the key reason behind poor youth employment outcomes.

3.1 Skills deficit and mismatch

Are young people not sufficiently skilled to get a job when there is a vacancy available? Such question may seem almost superfluous in the medium- to long-term when each generational change is accompanied by longer years of schooling, in most countries in the world, and young entrants are often referred to as a cohort that is 'better skilled than ever'.[10] Yet, when such young people have difficulties in getting jobs that are acceptable to them, the tendency has been to focus almost exclusively on the kind of skills that they have acquired and their relevance as to which skills are demanded in the market. As a result, much policy pressure is put on the providers of training to flexibly and continuously adapt to the labour market. But institutional and curricular adjustments to short-run fluctuations are fairly costly operations, particularly in a developing country context where labour market information is often missing or inaccessible. Coping with cyclical fluctuations would require a better balance between on-the-job and institutional training. In the longer term, institutional adjustments would indeed be needed to enable the supply side to match demand. The ILO advocates a 'common framework for skills development' in which (a) there is a consistent attempt by all relevant actors to match supply to demand for skills, (b) workers and enterprises are assisted by the government to adjust to change, and (c) efforts

[9] This is witnessed by a proliferation of 'treatment effect' literature in labour economics, especially in the 2000s. For example, see Imbens and Wooldridge (2009) for a recent review of existing approaches and their applications.

[10] This said, education and training continues to play a very important role in enabling young people to successfully enter the labour market.

are invested to build and sustain competencies for future labour market needs (ILO, 2011a:18).

As an example of longer term shifts in skills demanded in the labour market, an important issue that confronts more advanced countries has become a growing concern. One influential study on the United States has shown that demand for medium-skilled jobs that pay close to the median wage has fallen while there has been an increase in the demand for high-skilled jobs as well as for low-skilled jobs (Autor et al., 2003). This ‘missing middle’ and the polarization of the labour market has constrained employment opportunities for many young people forcing them to seek entry into low-skilled jobs, such as in the cyclically sensitive retail sector. There is also some evidence of this phenomenon in the UK (The ACEVO Commission on Youth Unemployment, 2012). More generally, projections for the 27 EU countries show that, between now and 2020, the proportion of jobs requiring medium-level qualifications will stagnate while the proportion of jobs with high qualifications will increase significantly (ILO, 2011a).

Have there been any skills deficits in the long run for young entrants? An examination of the relationship between young people’s educational attainment and their labour market outcomes shows that the nexus is fairly straightforward among high income countries, but much more complex among low and middle income countries (Figure A.2 in the Appendix). There are clear positive returns to longer years of schooling for young people in high-income countries, with respect to unemployment rates and employment-to-population ratios (EPRs). Countries with longer average years of schooling tend to have lower youth unemployment rates and higher EPRs.[11] In low and middle income countries, there appears to be a reverse relationship. Countries with longer average years of schooling tend to have higher youth unemployment rates.[12] This relationship is partially capturing the fact that unemployed youth in low and middle income countries are relatively better educated than their employed counterparts. As for lower employment-to-population ratios in countries with relatively more educated youth, it is capturing two aspects. First, longer average years of schooling implies that more young men and women stay out of the labour force to remain in education. Second, there may be an over-supply of educated youth in low and middle income countries, relative to demand. Mean years of schooling probably act as a surrogate for the socio-economic background of young people in low and middle income country settings. In the absence of comprehensive unemployment benefits schemes and other passive labour market measures, young people from poorer households can neither afford to stay unemployed nor remain longer in education.[13]

Furthermore, the relationship between educational attainment and youth labour market outcomes are complicated by youth’s supply behaviour. If jobs that offer adequate pay for invested skills are not found, young people either become inactive, discouraged,

[11] Some of the countries that exhibit both long average years of schooling and low youth unemployment rates include: Germany, Japan, Korea, Norway, and Switzerland. The countries at the opposite end of the spectrum are Bahrain, Croatia, Saudi Arabia, Spain, and Poland.

[12] These countries include Bolivia, Chile, Fiji, Sri Lanka, and Swaziland.

[13] The quality of education and training output is the main issue of interest. As a preliminary background data analysis, the relationships between PISA average scores on mathematics, reading, and sciences and youth labour market outcomes between 2000 and 2010 were examined. The relationships turned out to be orthogonal, however, both for high income and low and middle income countries. Moreover, the number of observations for low and middle income countries was extremely limited. For this reason, the current paper uses mean years of schooling as a proxy for educational and skills attainment.

unemployed, or enter the labour market by grasping any job available. The amount and duration of expectation adjustments also depends on the overall economic climate. If the economy is booming, adjustments to youth's reservation wages occur fairly slowly. Young people may continue searching for jobs, as long as they can afford it. If youth perceive that the economy is in recession or stagnation, adjustments to their reservation wages can happen fairly rapidly, and they may undertake any job that comes their way. Once young men and women settle for compromised opportunities in the labour market, the 'scarring effect' kicks in. This poses greater barriers – especially for those with limited skills – to make the transition to better jobs later on in life. Hence, an initial short-run demand shock can mutate into long-run labour market impairments, including lower life-time earnings for young workers (Genda et al., 2010).

This has important implications for the 'skills deficit' thesis as an approach to understanding poor labour market outcomes for young people. It suggests that the relationship between skills and youth employment and unemployment is not independent of the business cycle. In other words, downturns will cause an adverse shift in this relationship that cannot be immediately remedied during the recovery period, leading to poorer employment and earnings opportunities that can persist over time at any given level of skills. Attributing this shift to a skills deficit or a skills mismatch will be inappropriate because it will overlook the crucial role that business cycles and economic shocks, such as the one detailed in Section 2 of this paper, play in influencing the earnings and employment prospects of young people. On both the conceptual and empirical fronts, this sub-section has argued that supply-side oriented policy measures alone are not the key to improving youth employment outcomes. [14]

3.2 Insufficient labour market flexibility

Another influential view on factors that depress the demand for labour relates to the impact of specific labour market regulations – such as high minimum wages and high severance pay. These regulations set the rules of the game in the formal segment of the labour market. The price, it is claimed, is borne by young workers who then are 'priced out' of the labour market. For instance, it is well known that youth unemployment rates in the Middle East and North African region are among the highest in the world. A recent study claims that they are largely due to the supply side and overly rigid labour market regulations.[15] The discussion expands this thesis by focusing on (a) minimum wages and youth employment, and (b) severance pay and youth employment. It draws on a new IMF database on labour market regulations across countries to offer an empirical evaluation of

[14] The section has attempted to claim that filling the skills gap may not be the most effective way forward in improving youth labour market outcomes. Such claim has to be based on the premise that the on-going policy efforts to improve educational and skills outcome would indeed continue and further develop, as they should. However, measures to stimulate the demand side of the labour market are in order, and supply-side policies need to be better coordinated with such demand-side measures. For example, Rothstein (2012) claims that from a historical perspective (1983-2011) in the United States, there has been an unexplained long-run upward trend in the long-term unemployment share of 0.5 percentage point per year over the past two decades. Such trend is not attributable to changes in structural factors, such as skills and geographical mismatches, but rather to a sustained shortfall in labour demand.

[15] See, for example, Yasser (2011). For an alternative view, see Tzannatos et al. (2011).

the thesis that labour market regulations represent a major impediment to job creation for young people. [16]

The key message is that cross-country evidence does not necessarily support this contention. The policy implication is not necessarily more or less regulation, but an appropriate mix of policies and regulations that can maximize ex-ante net benefits for young workers in terms of protection against labour market risks while preserving employment opportunities. This message is consistent with state-of-the-art findings in the pertinent literature. For example, a study by the ILO and IILS (2012) provides a meta-analysis of more than 100 studies and finds that the evidence of the impact of employment protection legislation on employment is rather weak and mixed. There also appears to be a non-linear relationship between labour market regulations and employment, with both too lax regulations and excessive regulations leading to poor employment outcomes. More importantly, the study finds that, since 2007, the dominant trend is a decline in employment protection.[17]

Having set the context, the rest of the section discusses some new evidence on the relationship between labour regulations and youth employment. As noted, the focus is on minimum wages and severance pay both of which are contentious and the subject of current policy discourse cutting across low, middle and high income countries. While the neoclassical theoretical prediction associates higher minimum wages with higher youth unemployment rates[18], the empirical relationship is by no means as clear cut (Figure A.3 in the Appendix). Country-level averages for the period 1980-2005 show that, both among high income and low and middle countries, youth unemployment rates are only minimally and insignificantly associated with the average level of minimum wages.[19] In middle and low income countries, this weak relationship tends to be negative, albeit not statistically significant. Hence, long-run youth unemployment rates are determined by factors other than minimum wages, including country-specific diversity.

The other side of the coin is the relationship between average growth in youth employment and average growth in minimum wages (Figure A.4 in the Appendix). Growth in minimum wages is expected to be associated with lower growth in youth employment-to-population ratios. There is a significant negative relationship among high income countries. However, there is a positive but insignificant relationship among low and middle income countries.[20] In high income countries where minimum wages have risen faster during the period under consideration, employment-to-population ratios also tended to

[16] The evidence on labour market regulation is taken from the IMF database, described by Aleksynska and Schindler (2011).

[17] See also Bell and Blanchflower (2009) and Berg and Kucera (2008) for a review of the evidence on the regulations-employment nexus.

[18] Neoclassical framework is the one that is usually explicitly or implicitly adopted when gauging the impact of a change in minimum wages on employment. For this prediction to hold, the level of minimum wages has to be above the so-called market clearing wages.

[19] The time period coverage is different from the previous analysis to adapt to labour market regulation data available from the new IMF database, as described in Aleksynska and Schindler (2011).

[20] Note that the youth EPR is estimated from a cross-country regression model.

decline faster.[21] In low and middle income countries, however, faster growth in minimum wages was associated with faster growth in youth employment-to-population ratios. In this group of countries, average changes in minimum wages are poor predictors for average changes in employment-to-population ratios in the long run.

In summary, neither the level nor the change in minimum wages clearly contributes to youth labour market outcomes, even in high income countries. It requires a much more careful country by country examination on how changes in minimum wages affect labour market outcomes, relative to its past performance. While evidence on the extent of compliance with minimum wages is not included in the IMF database, it shows that compliance with minimum wages and the prevalence of the wage labour market in a country may play an important role.

On severance pay, it should first be noted that legally set severance pay does not change very often. The total number of incidence in upward or downward changes in the maximum severance pay amounted to nine cases in high income countries, thirty three cases in middle income countries, and eleven cases in low income countries. Moreover, due to limitations on youth employment and unemployment data, many episodes of change in severance pay regulation cannot be related to changes in the youth labour market outcome. With such limitation in mind, the summary table below shows that, on average, higher level of severance pay was associated with lower episodes of youth unemployment (Table 1). Hence, higher level of maximum severance pay does not seem to be associated with episodes of high youth unemployment rate. Rather, on average, it was more closely associated with episodes of low youth unemployment rate.

The topic of severance pay can also be used to illustrate how labour regulations can be reconfigured without reducing them. It seems to be strikingly high (when measured in terms of maximum months of pay) in developing parts of the world and rather modest in developed parts of the world. For example, severance pay ranges from 8.2 months in the Middle East and North Africa to 16.3 months in Latin America. On the other hand, it ranges from 1.1 months in North America to 3.4 months in Western Europe.[22] This is due to the fact that there is a reasonably comprehensive unemployment benefits scheme to compensate for modest severance pay at the firm-level. High severance pay is a contentious issue for employers in the developing world because they are seen to be bearing an unfair burden of financing periods of unemployment for workers. One way of resolving this issue is to broaden the coverage of unemployment benefits scheme for formal sector workers and combine them with employment guarantee schemes for rural and informal economy workers. Political commitment and adequate resource mobilization are needed to support such initiatives.

In sum, the relationship between youth unemployment and employment and labour market regulations is complex and diverse in and across countries.[23] This is particularly the case for middle and low income countries. It most likely reflects the weakness of labour

[21] For example Estonia, Hungary, Japan, Poland and the United Kingdom.

[22] Authors' estimates based on Aleksynska and Schindler (2011).

[23] Since labour markets tend to be 'imperfect' if left by themselves (missing information, asymmetric information between job seekers and employers, incentives to keep information asymmetric on the job, network effects, discrimination based on average observed attributes of a sub-population, etc.), the rationale for regulating labour markets is strong. Hence, the question is not about regulating versus not regulating, but rather about how to regulate.

market institutions in these countries, in terms of their implementation capacity and coverage. Hence, at this preliminary stage, it is not possible to judge the implications of labour market regulations for youth. This also means that labour market regulations do not seem to have a decisive impact on youth labour market outcomes, at least in the long run. Moreover, even in high income countries, the pay-off from regulations depends on what happens to the labour market over time, including changes in the macroeconomic environment that affects the demand for workers.

Table 1. Average severance pay in episodes of high and low youth unemployment

Maximum severance pay (months)	Episodes of high YUER	Episodes of low YUER
High income countries	5.5	5.8
Middle and low income countries	7.7	12.1

Source: IMF (2011a) and ILO (2011b).

Note: YUER = youth unemployment rate. Episodes of high youth unemployment rate refers to periods when youth unemployment rate in period *t* in a country was greater than or equal to the 1980-2005 period average in that country.

3.3 Shortfalls in labour demand

Labour market regulations and skills mismatch are likely to be more visible in times of recession or deflation than in times of economic expansion. For instance, when there is sufficient demand for workers, employers may overlook a mismatch in skills as long as young job applicants possess a core set of skills that can be further developed on the job. During contractionary period, on the other hand, there may be a tendency to seek out 'perfectly matching' job applicants, as employers are hard-pressed to make ends meet. This subsection examines the long-run demand side of the job market, as captured by the countries' GDP growth rates and other macroeconomic variables.

From a pooled cross-country data spanning over 1990 to 2010, the distribution of GDP growth rates can be categorized into 'low', 'medium', and 'high'. 'High' growth should be associated with better youth labour market outcomes, while 'low' growth is expected to be associated with poor youth labour market outcomes. The 'low' threshold is defined as two-third of the median GDP growth rate in the pooled data between 1990 and 2010 and the 'high' threshold is defined as four-third of the median. To derive the relevant median, the data was sub-divided into a sample of 'high income' and 'middle and low income' countries.[24] For example, the median GDP growth rate among high income countries between 1990 and 2010 is 3.1 per cent. Two-third of this gives the 'low' cut off point at 2.1 per cent and four-third gives the 'high' cut off point at 4.2 per cent (Table 2).[25]

Table 2 shows the long-run cross-country relationship along the classification of countries according to the distribution of GDP and GDP growth volatility around their

[24] For further details, see World Bank (2012b).

[25] There are some difficulties associated with this approach to classifying countries by comparing the median from the total observations and the period-median for each country. The number of observations per country differs due to constraints in data availability, and the median of all observations is influenced by countries that have more observations than those that have less. Hence, Table 2 does not represent a true cross-country comparison of averages. Nevertheless, the preliminary results provide some interesting insights.

median and their average youth labour market outcomes. With respect to annual GDP growth rate, the table shows a diverging pattern for youth labour market outcomes between high income countries on the one hand and low and middle income countries on the other. In high income countries, the economies that had grown fast on average during the past couple of decades tend to have slightly higher youth unemployment rates than those that grew more modestly. At the same time, the average youth EPR among the fast growers is low. Such situation may seem counter-intuitive, but it can be explained by taking into account young people's supply behaviour and incentives to invest in education. For example, because of fast economic growth, the perceived opportunities for better jobs have expanded. It gives incentives for youth to stay on longer in education in order to realize the emerging employment opportunities (and hence the lower average EPR among the fast growers). Higher average youth unemployment rate among the fast growers may be reflecting an over-supply of young labour force in response to the growing economy, as well as difficulties faced in having and retaining a job.

Among low and middle income countries, the median youth EPR rises as the countries' average growth rate rises. Higher growth is associated with better employment outcomes, even though the gain in the EPR is quite modest: 35.2 per cent for a group of countries growing at less than 2.9 per cent as against 41.4 per cent for a group of countries growing at more than 5.7 per cent. There is also a U-shaped pattern in youth unemployment rates; countries that grew in the medium range (2.9 to 5.7 per cent) exhibited the lowest median youth unemployment rate (17.8 per cent), while median unemployment rate increases to 20.0 per cent with faster GDP growth rates. As is the case for high income countries, this could be reflecting the supply behaviour of young workers in the market. It also means that growing as fast as possible is not necessarily the most effective way to improving youth employment outcomes. Yet, slow growth (less than 2 per cent per annum for developed countries and less than 3 per cent for developing countries) adversely affects jobs for young people.

The relationship between GDP growth volatility, as measured by the coefficient of variation, and the youth labour market outcome shows the same pattern in high income and low and middle income countries with respect to the youth unemployment rate but a different pattern with respect to the youth EPR. GDP growth volatility is associated with higher youth unemployment rates. Growth volatility implies higher average turnover in the economy, including jobs. With regard to EPR among high income countries, growth volatility is as also associated with high youth EPR. It implies that the process that generates volatility may also be generating jobs and encouraging youth participation in the labour market. In low and middle income countries, however, high growth volatility is associated with lower youth EPR.

One of the possible channels by which high growth volatility leads to low EPRs relates to decisions on investment.[26] Volatility in output increases risks and hence decreases the expected returns from investment. Yet, it is in particular long-term investments across key strategic sectors that tend to generate new regular employment opportunities[27], both as

[26] For the determinants of unemployment, Frenkel and Ros (2006), for instance, find that fast investment growth is associated with unemployment declines or only moderate increases in unemployment. There is also a significant correlation between investment volatility and employment. See ILO and IILS (2012).

[27] Such key strategic sectors are determined by the countries. For investments to be employment-generating, not all strategic sectors need to be labour intensive (e.g. energy-related sectors). The sectors that provide basic inputs to a wide range of other sectors (e.g. electricity generation and

a direct result of investments and often indirectly, as a result of positive externalities arising from such investments. Without investments that lead to expansion of existing economic activities and generation of new ones, only limited employment opportunities for new entrants can arise – mainly to replace those that have exited from the labour force for reasons, such as age and health.

Table 2. Growth, volatility and youth employment/unemployment

Sample of high income countries	Thresholds	Number of countries	Median YUER (%)	Median YEPR (%)
GDP growth (%)	Low (<2.1%)	9	13.8	41.9
	Medium (2.1% to 4.2%)	22	13.9	45.0
	High (>4.2%)	16	15.5	34.5
GDP growth volatility (CV)	Low (<0.7)	5	13.6	32.5
	Medium (0.7 to 1.3)	29	13.5	41.0
	High (>1.3)	13	17.6	42.3
Sample of low and middle income countries	**Thresholds**	**Number of countries**	**Median YUER**	**Median youth EPR**
GDP growth (%)	Low (<2.9%)	27	28.7	35.2
	Medium (2.9% to 5.7%)	78	17.8	40.3
	High (>5.7%)	31	20.0	41.4
GDP growth volatility (CV)	Low (<0.7)	42	17.3	43.9
	Medium (0.7 to 1.4)	47	18.1	38.4
	High (>1.4)	47	21.3	38.8

Source: IMF (2011b) for GDP growth, from which the coefficient of variation was calculated; and ILO (2011b) for youth unemployment rates and employment-to-population ratios.

Note: YUER = youth unemployment rate; YEPR = youth employment-to-population ratio.

Furthermore, certain sectors are also susceptible to economic shocks. As the global recession of 2008-2009 has shown, young employed in both traded (such as garments) and non-traded goods sectors (such as construction) that are sensitive to regional and global business cycles can be badly hit (Islam and Verick, 2011). A study by the ILO has shown that, in the case of Tanzania, a moderate reduction of its generally high degree of pro-cyclical spending could have added almost 170,000 jobs per year over the period from 1991 to 2008, equivalent to 10 per cent of its current employment level (ILO and IILS, 2010). Reducing macroeconomic volatility requires the use of timely and targeted counter-cyclical policies. This in turn necessitates enhanced fiscal and institutional capacity for countries to undertake counter-cyclical measures.

The descriptive analyses presented above can be supplemented by econometric investigations. Tentative insights can be gained from the multivariate regression results presented in Table 3. The estimated model attempts to connect macroeconomic variables with youth labour market outcomes. Youth unemployment rates are determined by supply-side and demand-side factors. The former is roughly captured by proxy measures for educational attainment. Demand-side factors are captured by investment, measured as gross

distribution, infrastructure) have a potential to generate jobs elsewhere. Hence, a combined targeting of investment in sectors that provide inputs to a wide range of businesses and households and sectors that are labour-intensive may lead to a broad-based increase in employment opportunities.

fixed capital formation as share of GDP, and the adult unemployment rate, which is used as a proxy measure for the overall economic and labour market environment. Dummies for the countries' income group categories and five-year time period intervals are included to capture unobserved differences that can arise between different income levels of the economy over different time periods. Investment as share of GDP, in turn, is postulated to depend on key macroeconomic indicators. The model uses pooled OLS, seemingly unrelated estimation (SURE).

Table 3. Youth unemployment rate and macroeconomic indicators

Dependent variable: youth unemployment rate (%)	**SURE, with pooled data (1990-2010)**		
High income countries (N = 343)	**COEF.**	**S.E.**	
Youth unemployment rate (%): Supply side			
Labour force with tertiary education (%)	-0.063	0.033	*
Constant	16.743	1.495	***
Youth unemployment rate (%): Demand side			
GFCF as % of GDP	-0.194	0.046	***
Adult unemployment rate (%)	1.720	0.061	***
Constant	9.875	1.268	***
GFCF as % of GDP: Macro determinants			
Real interest rate (%)	-0.204	0.068	***
Debt as % of GDP	-0.055	0.007	***
CV of annual inflation	0.755	0.331	**
Current account balance as % of GDP	-0.079	0.034	**
Total reserves in months of imports	0.518	0.101	***
Constant	23.686	0.680	***
Chi-squared statistics:			
Youth unemployment rate (Supply)	7.68		
Youth unemployment rate (Demand)	904.16	***	
GFCF	121.03	***	
Low and middle income countries (N = 204)	**COEF.**	**S.E.**	
Youth unemployment rate (%): Supply side			
Enrolment in secondary education (%)	0.021	0.040	
Constant	11.755	6.544	*
Youth unemployment rate (%): Demand side			
GFCF as % of GDP	-0.205	0.081	**
Adult unemployment rate (%)	0.845	0.068	***
Constant	12.519	4.030	***
GFCF as % of GDP: Macro determinants			
Real interest rate (%)	-0.113	0.028	***
Debt as % of GDP	-0.024	0.010	**
CV of annual inflation	-0.018	0.260	
Current account balance as % of GDP	-0.265	0.036	***
Total reserves in months of imports	0.331	0.095	***
Constant	20.807	2.445	***
Chi-squared statistics:			
Youth unemployment rate (Supply)	10.54	*	
Youth unemployment rate (Demand)	179.00	***	
GFCF	104.47	***	

Source: IMF (2011b) for data on inflation and debt; World Bank (2012b) for real interest rate, current account balance, and total reserves in months of imports; and ILO (2011b) for youth unemployment rates.

Note: ***, ** and * denote significance levels at 1%, 5% and 10%, respectively. Dummies for 5-year time interval (1990-94, 1995-99, and 2000-04) are included to account for time period effects. Dummies for OECD countries are included in the sample of high income countries, and dummies for low income and lower middle income countries are included in the sample of low and middle income countries. They are to take into account of other income-group specific effects that might exist. For reasons of space, the coefficients on these dummies are not presented.

In high income countries, the youth unemployment rate is negatively associated with the share of labour force with tertiary education at the ten per cent significance level (Table 3). In low and middle income countries, there is no statistically significant relationship between the secondary school enrollment rate and the youth unemployment rate. It suggests that increasing skills via higher education may not be the most effective policy tool to combat youth unemployment. On the demand side, the youth unemployment rate is negatively associated with investment among both high income and low and middle income countries at the one per cent significance level. Investment, in turn, is a negative function of the cost of credit (the real interest rate), the share of debt in GDP, and the current account balance. In the case of high income countries, volatility in the inflation rate seems to be positively associated with investment, while no obvious relationship can be discerned among low and middle income countries. Other than unaccounted factors captured by the constant term, adult unemployment rate seems to be one of the single biggest explanatory factor for youth unemployment (significant at one per cent).

While the supply side and regulatory environment in the labour market as well as the demand side matter for youth labour market outcomes to a varying extent, this section's analysis has demonstrated that stimulating labour demand needs further attention. How widely are policy interventions used to boost the demand for skills and services of young people? The answer seems to be: surprisingly little. In a review of 289 interventions targeted towards the youth labour market in 84 countries, one study finds that programmes pertaining to wage subsidies were identified in 17 cases and public works programmes directed towards youth were implemented in only eight cases (Puerto, 2007). There were no identified cases in which alleviating the financial constraints on private sector growth played a key role. In general, there was a bias towards supply-side interventions. This bias is striking because it seems to presume that supply-side factors are more important than demand-side factors in influencing youth labour market outcomes. Such presumption cannot be supported by the available evidence (ILO, 2010b; World Bank, 2010a; Betcherman et al., 2007).[28]

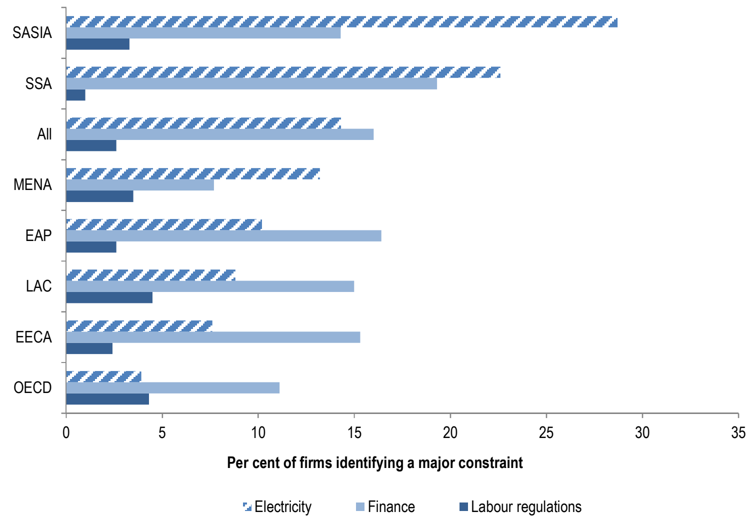
[28] See also Table 2.1 in ILO (2012) for the different types of interventions to boost employment opportunities for young people.

4. Binding constraints on the private sector as a vehicle of job creation: Issues, evidence and macroeconomic policy implications

It is frequently argued that structural factors, most notably lack of experience and skills as well as labour market regulations, constitute major barriers to employment for young men and women. This notion, however, neglects the relevance of the macroeconomic environment in influencing youth employment. The relationship between GDP growth and youth labour market outcomes and that between investment and some macroeconomic variables have been examined in the preceding section. A further step is to examine the perceptions of the private sector with respect to binding constraints on the expansion of business operations. Macroeconomic policies can therefore play a constructive role in employment generation by alleviating constraints on the capacity of the private sector to create jobs.

Enterprise level surveys show that across various regions of the world, particularly in developing countries, firms highlight access to finance and use of reliable supply of electricity as major constraints for doing business. The issue of inadequate financing is particularly severe in Sub-Saharan Africa, the East Asia and Pacific region as well as in Eastern Europe and Central Asia where more than 15 per cent of firms identify a lack of access to finance. Problems related to infrastructure are most prevalent in South Asia and Sub-Saharan Africa where supply of electricity has been found to hamper business operations for 29 per cent and 23 per cent of surveyed firms, respectively. Labour regulations, on the contrary, constitute a business constraint for less than five per cent of firms across all regions and are, except for firms in high income OECD countries, less problematic than access to finance and electricity (Figure 4).

Figure 4. Major business environment constraints faced by firms across regions of the world



Source: World Bank (2012a).

Note: SSA = Sub-Saharan Africa; SASIA = South Asia; OECD = High income Organization of Economic Cooperation and Development; MENA = Middle East and North Africa; LAC = Latin America and the Caribbean; EECA = Eastern Europe and Central Asia; EAP = East Asia and the Pacific; All = All regions of the world.

A similar pattern emerges when alternative data sources are used. For instance, executive opinion surveys undertaken in more than 100 countries in the Global Competitiveness Report produced by the World Economic Forum point out that access to finance is considered as one of the five 'most problematic factors in doing business' by respondents in 85 per cent of the cross-country sample that cuts across high, middle and low income countries. In Sub-Saharan and North Africa insufficient lack of financing and inadequate infrastructure are ranked among the five most constraining factors in as much as 94 per cent and 72 per cent of countries respectively. In contrast to what is commonly claimed, an inadequately educated workforce is not cited as one of the top five major hindrances to business operations in two-third of the surveyed countries (World Economic Forum, 2011).

The findings presented above suggest that a two-tier approach, focusing on both access to finance and infrastructure investments, is needed. Appropriate changes in the design of monetary and financial policies will help to enhance access to finance. While constituting a principal concern of central banks and financial ministries, the World Economic Forum's Global Competitiveness Report shows that inflation, particularly in low and middle income countries, is not perceived as one of the major five growth constraints for the private sector. While this does not imply that the relevance of inflation for a stable macroeconomic environment should be neglected, it suggests that central banks' mandate should be broadened to include the stabilization of employment. This requires extending the scope of the policy mix to encompass other macroeconomic variables, such as investment allocation and the real exchange rate (Epstein and Yeldan, 2008).[29] Such measures would foster the expansion of existing business operations through increased private investment and allow governments to exploit entrepreneurial potential among youth through adequately responding to their financing needs. In addition, alleviating binding constraints on private sector growth requires a significant scaling up in public investment into infrastructure. It is therefore vital to mobilize resources enabling governments to bridge infrastructure spending gaps. Although the gap between supply and demand of infrastructure is nowhere as wide as in Sub-Saharan Africa, infrastructure requirements are also enormous in developed economies.[30] Evidence confirms that the benefits of infrastructure investments are considerable. According to a recent study, infrastructure contributed to over half of Africa's improved growth performance (World Bank, 2010b). Likewise, China's infrastructure investment strategy, implemented between 1990 and 2005, has had a significant impact upon the economy's performance (Lin and Doemeland, 2012).

Consequently, macroeconomic policies can play a major role in alleviating constraints on private sector development and thereby lower barriers to employment for young people. Measures aiming at improving financial inclusion in conjunction with enhancements in infrastructure are likely to stimulate labour demand and to thereby generate new employment opportunities for young people.

[29] The role of the real exchange rate in influencing employment is discussed in greater detail in Section 6.

[30] Current infrastructure spending needs for Sub-Saharan Africa are estimated to amount to USD 94 billion (in 2005 constant terms), corresponding to 8.9 per cent of GDP. Estimates from the OECD Infrastructure Project indicate that annual infrastructure spending needs in OECD countries correspond to 2.5 percent of global GDP through 2030. See World Bank (2010b) and OECD (2007).

5. Some policy issues: The fiscal implications of labour market policies

Active measures, such as training programmes targeted towards job-seeking young men and women, require both sufficient and predictable funding for their sustainability. Similarly, the implementation of either a comprehensive employment guarantee scheme or an unemployment benefits scheme has fiscal implications. While there is some impact evaluation of various youth labour market programmes, very little assessment has been undertaken on the financial and fiscal implications of such interventions.[31] This is, however, of considerable importance because youth employment programmes in some parts of the world, notably in Sub-Saharan Africa, are almost entirely dependent on external funding, hence raising legitimate questions about their fiscal implications.

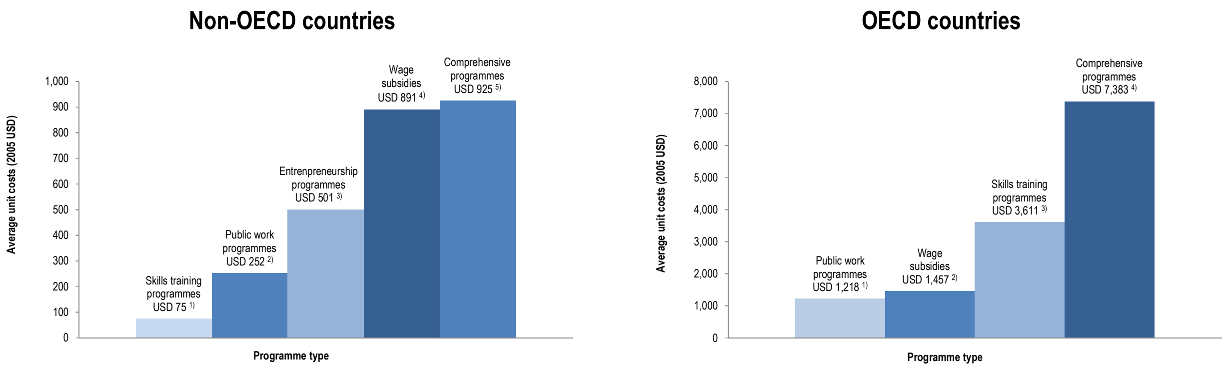
A necessary ingredient in undertaking financial and fiscal sustainability analyses is to have an assessment of the unit costs of programme delivery pertaining to various interventions. Aggregate resource requirements can then be worked out based on coverage rates. Such information is relatively rare. What one observes is that unit costs vary enormously, both across countries and across programmes, ranging (at 2005 prices[32]) from as low as USD 39 per beneficiary in Bulgaria to as high as USD 17,151 USD in the United States. Examining the unit costs separately for a selected set of non-OECD and OECD countries shows that youth employment programmes tend to be significantly more expensive for the latter. While average programme costs in non-OECD countries range from USD 75 to USD 925 per beneficiary, they reach up to USD 7,383 in OECD countries (Figure 5). It can be observed that the disparity in unit costs is most pronounced for skills training programmes, which on average amount to USD 3,611 in OECD countries as compared to USD 75 in non-OECD countries. Across programme types, unit costs vary considerably, with comprehensive measures constituting the most costly interventions. The most cost-effective appear to be public works and skills training programmes (Puerto, 2007).

A review of public expenditure on labour market programmes (LMPs) across the OECD region (Figure 6) demonstrates that spending on active measures averaged 0.6 per cent of GDP over the period from 2000 to 2007. Most governments spent a higher proportion of their budget on passive LMPs than on ALMPs, with average OECD expenditure amounting to 0.87 per cent of GDP. Whereas 13 countries allocated more than the OECD average on active measures, only eleven countries exhibited above-average spending on passive measures. The fact that OECD members spent on average less than one per cent of GDP on both active and passive LMPs, indicates that labour market programmes are typically implemented at moderate costs. This might inspire emerging economies, such as Mexico, that currently spend very little on labour market policies as a proportion of GDP. Boosting spending on such policies, and finding the necessary fiscal policies to support such spending, might pay off dividends as the subsequent discussion suggests.

[31] Among the 289 studies documented in the World Bank's Youth Employment Inventory, 25 per cent provide estimates on the programme's net impact. See Puerto (2007).

[32] Not adjusted for purchasing power parity.

Figure 5. Unit costs of youth employment programmes in non-OECD and OECD countries

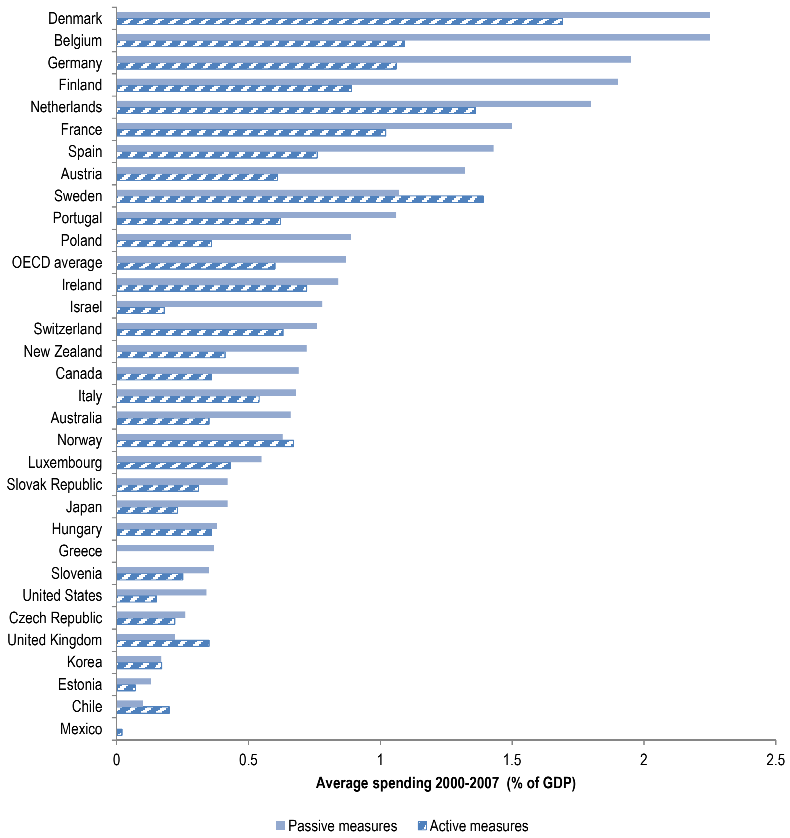


1) Brazil, Bulgaria 2) Bulgaria 3) Bulgaria, Peru 4) Poland 5) Argentina, Peru

1) Poland 2) Czech Republic, United States 3) Czech Republic, Hungary, Poland, Turkey, United States 4) Canada, Chile, United Kingdom, United States

Source: Authors' calculations based on Puerto (2007).

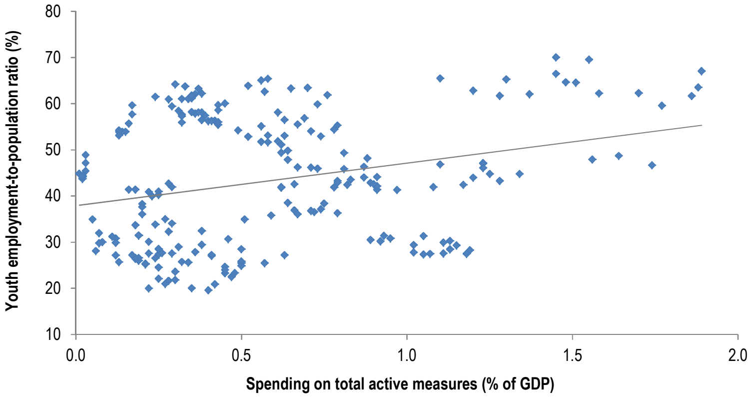
Figure 6. Average spending on LMPs in OECD countries, 2000-2007



Source: OECD (2012b).

In order to make some inferences about the financial and fiscal sustainability of employment programmes, it is pertinent to examine the relationship between public spending and labour market outcomes for young workers. Evidence from OECD countries over the period from 2000 to 2007 reveals a noticeable correlation between expenditure and youth employment. The analysis shows that higher spending on ALMPs is associated with substantially higher employment-to-population ratios for young workers. Figure 7 illustrates this relationship for active measures on an aggregate level; the fitted line indicates a positive relationship between resource allocation and youth labour market outcomes. The correlation remains positive for active measures involving training, a LMP component which has been found to be of particular relevance to youth employment.[33] Figure A.5 in the Appendix demonstrates that youth EPRs tend to be higher as spending on training, including special support to apprenticeship, increases.[34]

Figure 7. Spending on total active measures and youth employment in OECD countries, 2000-2007



Source: OECD (2012b).

Note: Poolability test results indicate that the data is poolable.

A closer look at passive LMPs demonstrates that higher expenditures on out of work maintenance are, as opposed to as what might be a priori assumed, not associated with lower youth employment-to-population ratios. Figure A.6 in the Appendix clearly illustrates a positive relationship between spending on unemployment benefits (ranging from 0 to 2.2 per cent of GDP) and employment of young people, indicating that social protection might be an important determinant of youth labour market outcomes.

The analysis of expenditure on labour market interventions also provides evidence on the relationship between spending and the duration of youth unemployment. A negative correlation can be observed for both active and passive measures. This implies that LMPs might be important to reducing unemployment rates and also play a crucial role in tackling long-term youth unemployment, a matter which has been of increasing concern in recent years. Besides, further investigations show that the association between spending on labour market measures and youth employment continued to be positive during the global economic and financial crisis of 2007-2009. These findings thus not only suggest that an increase in labour market expenditure could potentially have a significant impact at moderate cost, but support the validity of LMPs as a policy instrument that could be useful for the protection and activation of young workers, i.e. those who have turned out to be the most vulnerable during labour market downturns.[35] Future knowledge-building activities on

[33] For instance, since 2008, youth unemployment in Germany has decreased as a result of efficient apprenticeship programmes. See Morsy (2012).

[34] Due to the limited scope of this paper, the labour market insertion rate following training measures is not analyzed. More broadly speaking, Card et al. (2010) find that based on their meta-analysis of a sample of 199 ALMP evaluation estimates, many programmes have significantly positive impact after 2 or 3 years, even if their impact was insignificant a year after the programme.

[35] Once again, the impact of economic downturns on labour market outcomes should not be discounted. During normal periods of growth, active labour market policies have a useful role to

youth employment programmes should therefore treat them as part of fiscal policy design. This approach will motivate policy makers to focus on assembling regular and rigorous knowledge of the long-run fiscal requirements of youth employment programmes, in turn enabling the development of a credible resource mobilization strategy to enhance their viability.

play, but during significant downturns they cannot act as a substitute for aggregate demand management policies. Note that the evidence assembled here focuses on a period before the global economic and financial crisis of 2007-2009.

6. Some policy issues: Exchange rate management and its implications for youth employment

Economic diversification and productive transformation play a major role in creating employment opportunities in new areas and activities. This is where a key macroeconomic policy variable – the real exchange rate – is of considerable relevance. Other than affecting investments' expected returns through macroeconomic volatility and policy uncertainty, the real exchange rate can play a crucial role in diversifying the economy. Cross-country empirical studies have shown that a stable and competitive real exchange rate, supported by prudent capital account management, can incentivize firms to expand their export activities and thereby positively influence resource allocation between the traded and non-traded sectors. The resulting increase in investment and economic growth not only leads to higher employment generation but also promotes diversification and modernization in other sectors. In addition, the level of the real exchange rate affects labour market outcomes through its impact on the labour intensity of production. Significant and lasting changes in relative prices encourage the utilization of more labour-intensive technologies and a shift in resource allocation towards labour-intensive tradable goods. Positive effects may also become visible in the non-traded sector through the effect of the exchange rate on relative prices of imported production components. A competitive and stable real exchange rate may thus become an engine of job creation both for adults and young workers (Epstein and Yeldan, 2008; Rodrik, 2008; Frenkel and Ros, 2006; Williamson, 2003).[36]

Country-specific evaluations undertaken by the ILO and others indicate that an inappropriate exchange rate regime hurts growth and employment prospects, including for young people. The current Eurozone debt crisis, which has particularly affected countries such as Greece, suggests that a fixed exchange rate regime as manifested in a common currency area can turn out to be a crucial impediment to job creation by depriving member states of crucial policy and fiscal space. In principle, a policy of 'internal devaluation' can act a substitute for exchange rate devaluation, but in a period of very low inflation (as is the case of the EU), this entails cuts to nominal wages in the short run. The evidence to date suggests that internal devaluation is a painfully slow process with uncertain prospects.

What about the role of the exchange rate in influencing structural change and employment prospects in low and middle income countries? Some country-specific examples can be offered. In Malawi, an overvalued currency has led to an import boom and the contraction of import-competing domestic industries in recent years (see Box 1) (Deraniyagala and Kaluwa, 2011). In El Salvador, the 'dollarization regime', while bringing some benefits in terms of price stability, has hurt international competitiveness and the job creating potential of the economy. In Argentina, Brazil, Chile and Mexico, in contrast, periods of depreciated exchange rate levels between the 1980s and the early 2000s coincided with positive changes in employment trends. The role of the exchange rate for labour market outcomes has become particularly evident in the case of Argentina where the recession and job crisis of 1999-2002 was precipitated by a fixed exchange rate regime that

[36] The catalytic effect of exchange rate devaluations may diminish once such policies are simultaneously pursued by several economies. Moreover, competitive devaluations should not be resorted to by leading economies in order to achieve export-led recovery from the current recession, since such moves could potentially impede concerted global efforts.

could not be maintained.[37] The subsequent economic and jobs recovery was propelled by the single-minded pursuit of the Argentinian authorities to design and implement a stable and competitive real exchange rate regime (Damill et al., 2011; Weisbrot et al., 2011; Frenkel and Ros, 2006).

Box 1

The exchange rate regime and its implications for growth and employment in Malawi

The case of Malawi illustrates that macroeconomic policy, especially the exchange rate policy, plays a vital role in affecting economic growth and employment creation. With a view of reducing inflation, it has been long-established economic practice in Malawi to attempt sustaining a stable nominal exchange rate, i.e. to peg the Kwacha to the US dollar. The government has argued that the anti-inflation dimension of exchange rate policy is worth preserving since export supply is not very responsive to the exchange rate. While this position may be true in the short run, it ignores the role that a competitive real exchange rate plays in supporting structural transformation in the medium and long term. The study shows that, given the higher inflation rate in Malawi relative to its trading partners, maintaining a stable nominal exchange rate results in real appreciation and also induces volatility. Moreover, evidence has shown that appreciation of the real exchange rate is associated with the steep rise in import penetration from 44 to 53 per cent of GDP between 2007 and 2008. Such being the case, policy makers are urged to recognize that a competitive and predictable real exchange rate regime would most likely have encouraged firms to invest more and diversify and to thereby generate more jobs for the Malawian economy.

Source: ILO (2010a).

Giving greater weight to the exchange rate as part of a balanced macroeconomic policy mix could thus trigger new employment opportunities for youth and adults. Especially in low and middle income countries, the real effective exchange rate is a variable which can be looked upon as a policy tool that is potentially effective in facilitating diversification and productive transformation. The degree to which exchange rate targets can be feasibly pursued is ultimately dependent upon central banks' capacity to perform the necessary operations. The pursuit of a stable and competitive real exchange rate should be embedded in a policy mix consistent with broader objectives, including both inflation and employment targets.

[37] Studies have shown that, even though fiscal policies are frequently cited as the cause of the Argentine economic malaise, the true origins of the crisis were caused by country's currency regime. See Damill et al. (2011) and Setser and Gelpern (2006).

7. Conclusion

Lack of job opportunities for young people has become acute in the wake of the global financial and economic crisis of 2007-2009. This has become painfully evident in the advanced economies, and most notably in the Eurozone and the UK. The switch to fiscal austerity programmes between 2009 and 2010 impaired an incipient recovery and compounded the human misery of youth unemployment. Both the Eurozone and the UK are in the throes of a ‘double dip’ recession. Spain has the dubious distinction of having 50 per cent of its young people without a job. The tragedy is that a short-run demand shock can mutate into long-run ‘scarring’ effects as young people entering the labour market end up with suboptimal earnings and employment prospects that can last for decades. Those who are in the low end of the skill spectrum are especially vulnerable to ‘scarring’ effects. Furthermore, high and persistent youth unemployment engenders negative externalities entailing higher incidence of unhappiness, higher crime rates and higher inequality. As the recent turbulence in the Arab states has shown, unfulfilled job aspirations among young people can fuel political unrest. At the same time, there are growing concerns about the political and social sustainability of fiscal austerity programmes in the advanced countries, given that they have exacted a heavy human cost.

The paper drew on such a grim context to review the salient issues and evidence – and provide new evidence – on the drivers of poor youth employment outcomes. The paper noted that, in the case of debt-distressed Eurozone economies, the prevailing fiscal austerity programmes would probably need to be reviewed. There is a case for a ‘back-loaded’ or gradual approach to fiscal consolidation measures combined with fiscally neutral ways of boosting job opportunities for young people. At the same time, given that individual member states of the Eurozone cannot run independent monetary and exchange rate policies, the ECB can be more supportive of growth by directly purchasing bonds from debt-distressed economies. This is likely to reduce borrowing costs and provide much needed breathing space for governments of these economies to engage in targeted interventions to aid and abet young job seekers. This view is no longer the provenance of long-standing critics of fiscal austerity measures. They are increasingly being echoed by prominent and mainstream economists.

Turning to the long-run and cross-country perspectives on youth employment, the paper noted a perennial debate on the drivers of poor labour market outcomes for young people. Some see it as a skills deficit or a skills mismatch issue, while others focus on insufficient labour market flexibility as the primary cause of the underutilization of the skills and talents of young people. These views, while influential, are afflicted by various complications. The relationship between skills (as measured by mean years of schooling) and youth unemployment is not independent of the business cycle. Youth unemployment rates are especially sensitive to business cycles. Higher skills will not necessarily translate to higher employability in a downturn. Furthermore, higher mean years of schooling appear to be associated with higher youth unemployment and lower youth employment-to-population ratios in low and middle income countries. Given that mean years of schooling act as a surrogate of the socio-economic background of young workers, and given the lack of a comprehensive unemployment benefits scheme in low and middle income countries, those with low skills and low schooling cannot afford to stay unemployed relative to their better schooled (and presumably more affluent) counterparts. Hence, there is a tenuous connection between schooling and employment in developing countries. One requires a nuanced approach to skills development policies.

The paper remarked that the view that employment protection legislation as the most important impediment to promoting jobs for young people is rather influential. Yet, it is not anchored in robust evidence. This paves the way for suggesting that macroeconomic and demand-side factors probably have the most potent influence in shaping employment outcomes for young people both in the short run (through business cycle effects) and long run (through the nature and pattern of growth). The paper drew attention to the fact that policy interventions to assist young job-seekers do not seem to be sufficiently aligned with the pertinent evidence on the drivers of youth employment. The prevailing pattern is a bias in favour of supply-side interventions. Hence, good policy design needs to rectify that bias.

The paper also made specific policy recommendations on the roles and responsibilities of macroeconomic policy managers as they pertain to the challenging task of tackling the youth employment crisis. One of the most effective ways of helping young people to attain a durable foothold in the job market is to understand the binding constraints that impede growth of the private sector. Here, prevailing presumptions need to be revisited. Inflation risks – the standard preoccupation of central banks and finance ministries – and labour market regulations – the standard preoccupation of many commentators – do not seem to be of central concern to the private sector. Instead, enterprise-level surveys reveal that lack of access to finance is cited as among most important factors constraining business opportunities in low, middle and high income countries. In low and middle income countries, inadequate access to infrastructure is also seen as a binding constraint on doing business. The macroeconomic policy implications are clear. An agenda of financial inclusion must be at the core of the mandate of central banks and financial authorities. Similarly, identifying fiscally sustainable resources to support adequate investment in infrastructure is a key policy concern – a finding that is backed up by econometric evidence based on cross-country data showing that lack of investment is closely associated with poor employment outcomes for young people.

The paper also noted – based on evidence from the OECD – that higher spending on labour market policies (measured as a proportion of GDP) seems to be associated with better employment outcomes for young men and women during normal periods of growth. A plausible policy lesson is that low and middle income countries can boost employment opportunities for young people by boosting spending on labour market policies. This requires a prior assessment of the fiscal space that is available to boost such spending.

The paper argued, based on available evidence, that an important macroeconomic policy instrument to facilitate structural transformation and hence more diverse employment opportunities – both for adults and young people – is the exchange rate. This can be embedded in a balanced policy mix enabling central banks to focus on a broader set of objectives and to thereby positively impact labour market outcomes.

In sum, the youth employment crisis that prevails today is neither inevitable nor can it be left unresolved. Otherwise, one will be left with a scarred generation amidst high political and social instability. The reasons behind the acute lack of employment opportunities for young men and women are reasonably well known and the policy lessons that can be gleaned from such reasons are also known. Certainly, structural and supply-side factors – such as skills deficits and labour market regulations – play a role, but they are not as potent as macroeconomic and demand-side factors. Resolute action to tackle the youth employment crisis of today needs to proceed from that premise.

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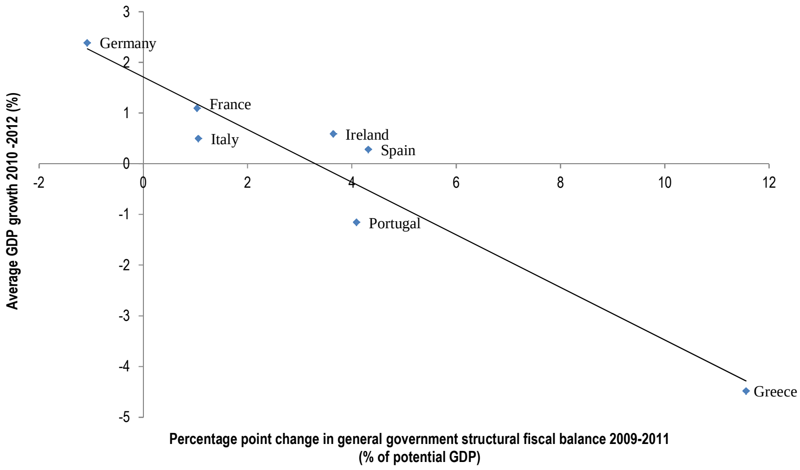
Appendix

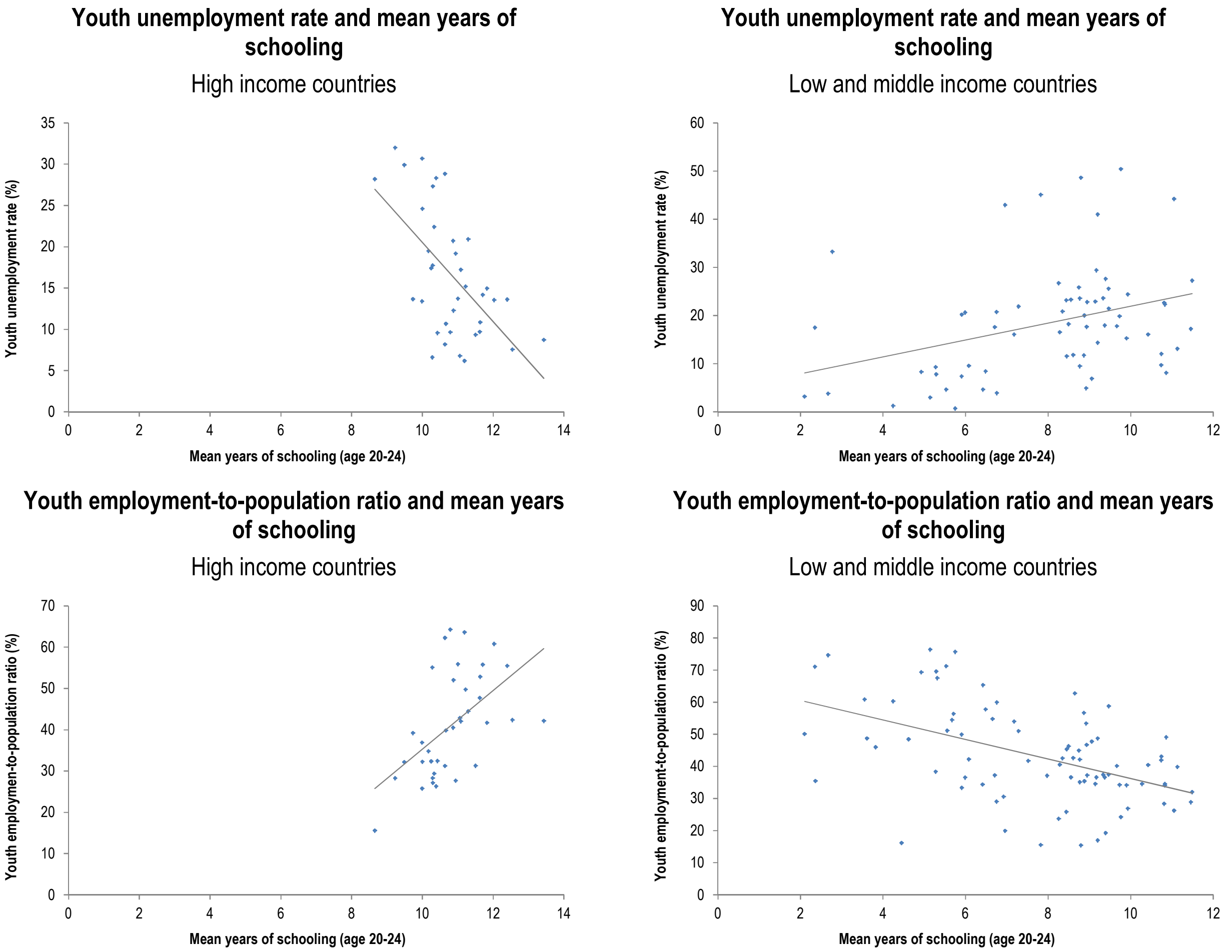
Figure A.1. Fiscal tightening and GDP growth across selected EU countries



Source: World Bank (2012b) for GDP growth 2010; OECD (2012a) for GDP estimates 2011-2012; and Economy Watch (2012) for general government structural fiscal balance (% of potential GDP).

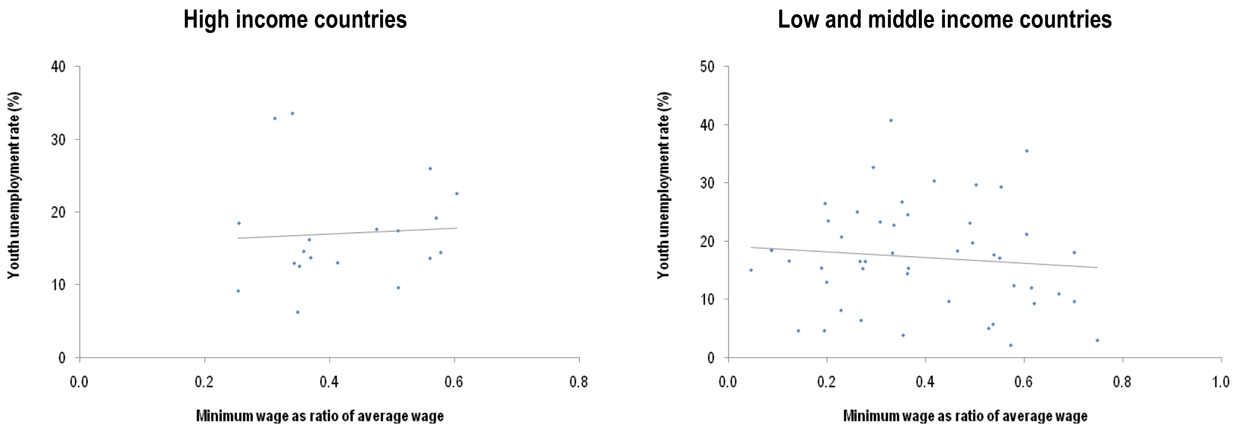
Note: Correlation coefficient = -0.96; R^2 = 0.92.

Figure A.2. Mean years of schooling and youth unemployment/employment, country-level period average 1990-2010



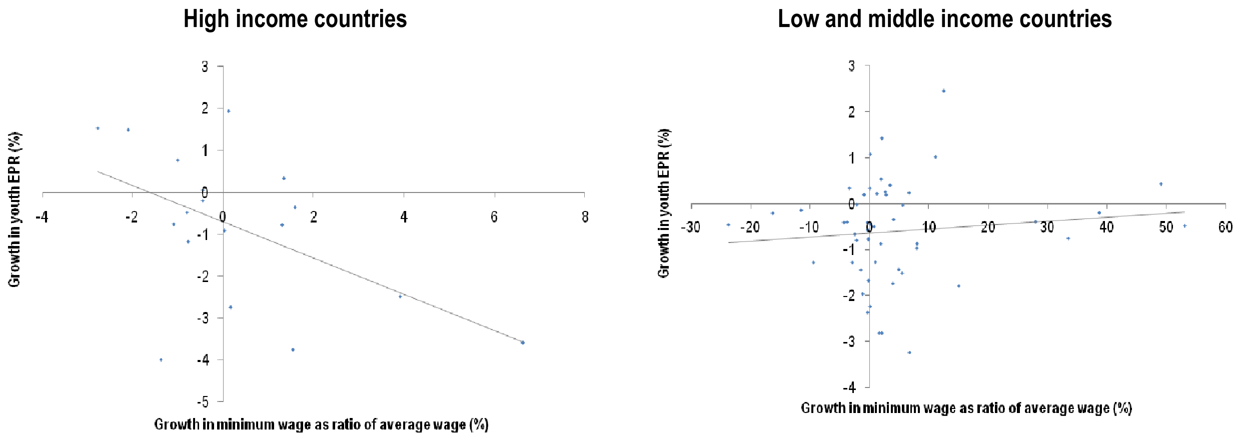
Source: World Bank (2012b) and ILO (2011b).

Figure A.3. Youth unemployment rate and minimum wages, country-level period average 1980-2005



Source: Minimum wages from IMF (2011a); and youth unemployment rates from ILO (2011b).

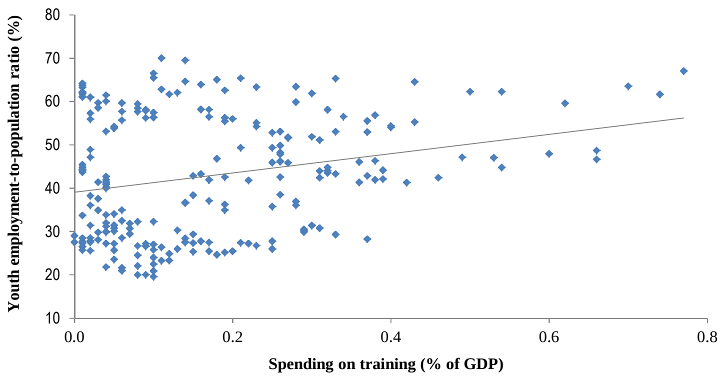
Figure A.4. Growth in youth employment-to-population ratio and minimum wages, country-level period average 1980-2005



Source: Minimum wages from IMF (2011a); and youth EPRs from ILO (2011b).

Note: Growth in minimum wages is growth in minimum wage as ratio of average wage. The categorization into low, middle and high income countries is based on current World Bank country classification criteria. For low and middle income countries, outliers with more than 100% average increase in minimum wages are excluded from the presentation (Argentina and Ukraine).

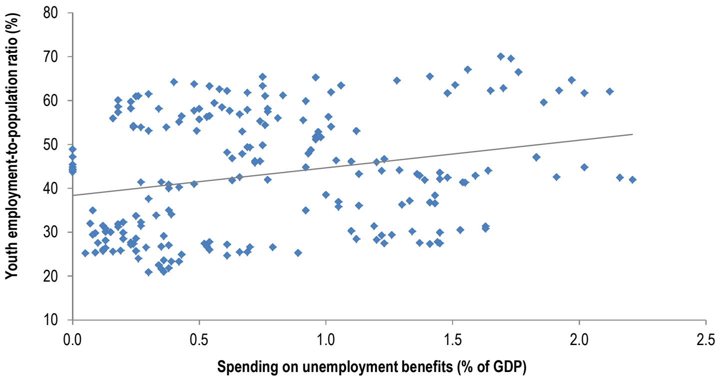
Figure A.5. Spending on training and youth employment in OECD countries, 2000-2007



Source: OECD (2012b).

Note: Poolability test results indicate that the data is poolable.

Figure A.6. Spending on unemployment benefits and youth employment in OECD countries, 2000-2007



Source: OECD (2012b).

Note: Poolability test results indicate that the data is poolable.

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