



Who is Europe's "lost generation"?

An anatomy of (un)employment demographics in Europe

February 3, 2014

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Even though unemployment in the euro area finally seems to have peaked, the employment crisis remains one of the main political and economic challenges in Europe. Even under optimistic growth scenarios it will take many years to achieve a substantial reduction in the number of unemployed.

The burden of the crisis is shared very unequally across generations and the euro area periphery faces an often termed "lost generation" which encounters unusually adverse labour market conditions. Especially youth unemployment rates of more than 50% in Greece and Spain, and around 40% in Italy and Portugal, will remain one of the main concerns.

Unlike the simplistic emphasis on youth unemployment suggests, there is a disproportionate incidence of adverse employment effects also for young cohorts of the prime labour market age. Most countries in the euro area periphery also registered a particularly large drop in employment rates for those between 25 and 34. For the members of this group it is generally more difficult and less useful than for the under-25s to avoid extended periods of unemployment by remaining longer in education or pursuing additional training.

A related development is the steeply rising incidents of long-term unemployment among younger cohorts. While the share of those who are unemployed for more than 12 months is higher among more mature workers, it has been rising steeply for younger cohorts. In the age group between 25 and 29 years, already between 40 and 60% in the euro area periphery are unemployed for more than one year.

Most countries suffering from high unemployment have started to take serious measures to facilitate job creation and the transition from education to work. A further reduction of the still existing labour market duality, investments in the employability of school leavers and incentives for companies to contribute to the skill formation of inexperienced workers, appear warranted. It is also important to design effective activation policies, which are not only aimed at the under-25s, but also include younger cohorts in the prime labour market age.



Who is Europe's "lost generation"?

A "lost generation" in Europe?

Unemployment projections
by the European Commission (in %)

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	2013	2014	2015
Euro area	12.2	12.2	11.8
Greece	27.0	26.0	24.0
Spain	26.6	26.4	25.3
Portugal	17.4	17.7	17.3
Ireland	13.3	12.3	11.7
Italy	12.2	12.4	12.1
France	11.0	11.2	11.3
Germany	5.4	5.3	5.1

Source: European Commission Autumn Forecasts 2013

The euro area will return to growth in 2014, but even though unemployment seems to have reached its peak the employment crisis in Europe is far from over. In 2008 the euro area unemployment rate stood at 7.6% and no single country had an unemployment rate in excess of 9%. At the end of 2013, 26.7 million men and women were unemployed and the average unemployment rate was 12.1%. The highest rates by far were recorded in Spain (26.7%) and Greece (27.3%). In the medium term, this situation will not improve substantially. For 2015, the European Commission's autumn forecast still predicts an average rate of 11.8% for the euro area (see Box 1).

Even more alarming are the reported youth unemployment rates – above 50% in Spain and Greece and close to 40% in Italy and Portugal. Europe is facing an often cited "lost generation", a substantial share of whom is either unsuccessfully looking for a job or remaining in (higher) education or professional training longer than individually preferred and economically rational. The European Commission has created a EUR 8 bn fund earmarked for regions where youth unemployment exceeds 25%, but the impact of such a programme is likely to be limited.

In statistical terms, "youth unemployment" refers to the age bracket 15-24 years. However, the overly simplistic distinction between youth and prime-age unemployment ignores that adverse conditions for young cohorts are becoming more and more persistent. Also those in their late 20s or early 30s are disproportionately affected, and individually they may be even harder hit by longer periods of unemployment. Unlike the under-25s, those around 30 have few options to escape long-term unemployment by returning to education or training. They also may already have made substantial investment decisions, e.g. buying property, which they cannot finance while being unemployed. And it is unclear whether "scarring effects" (the effect of an extended period of unemployment on future wages) for them will be lower than for those without prior labour market experience than. If we look at the evolution of employment rather than unemployment, it becomes clear that also those between 25 and 35 are particularly affected by the crisis in the euro area periphery.

Measuring youth unemployment: a tricky exercise

Measuring youth unemployment

2

According to the definition of Eurostat, the youth unemployment rate is the total number of those unemployed divided by the total number of people in the labour market (employed plus unemployed). In the EU there are currently 5.7 million unemployed persons aged 15-24 and around 24 million persons of that age group in the labour market, so the youth unemployment rate is 23.6%.

By contrast, the youth unemployment ratio relates those who are unemployed to the total number of persons in the relevant age group (employed plus unemployed plus inactive). Thus the denominator is always larger and the youth unemployment ratio is by definition smaller than the youth unemployment rate. The 5.7 million unemployed are divided by all 58 million persons aged 15-24 in the EU, which gives a youth unemployment ratio of 9.8%.

See also: Eurostat – Statistics Explained

http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Youth_unemployment

As the youth unemployment rate refers to the population between 15 and 24, it merges two very different groups. Those between 15 and 19 have a very low average participation rate because they are mostly still in education or training. In contrast, most members of the age group 20-24 are completing education and entering the labour market for the first time. Overall, the majority of those aged between 15 and 24 is not yet part of the labour force (57.9% in the EU28 for 2012), which complicates comparisons with other age groups.

The youth unemployment *rate* is computed as the percentage of the unemployed aged between 15 and 24 compared to the total labour force (both employed and unemployed) in that age group. However, as most students are not part of the labour force, the denominator is small and the youth unemployment *rate* is biased upwards. Thus, youth unemployment rates are generally higher than the overall rate and those of other age groups.

As an alternative measure, Eurostat also reports the youth unemployment *ratio*. Here the denominator consists of all persons aged between 15 and 24, irrespective of their labour market status. Then the numbers look much less alarming – 20.2% for Spain, 16.1% for Greece, 14.1% in Portugal and 9.6% for



Who is Europe's "lost generation"?

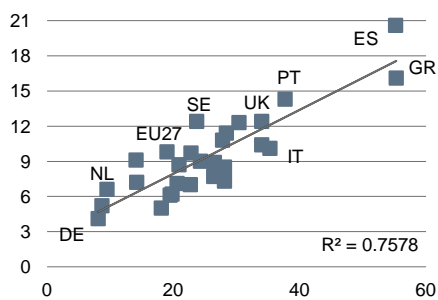
the euro area average, and Barslund and Gros (2013) have suggested that the youth unemployment ratio is a more informative measure.¹ However, the youth unemployment *ratio* is biased as well, but in this case downwards. For example, it does not take into account that potential school-leavers may not join the labour force and remain in education because they could not find a job, or return to university in order to avoid a potentially "scarring" unemployment spell, even though they would have preferred to work. It also ignores those without a job who are not registered as unemployed.

Despite the large absolute difference between the youth unemployment rate and ratio in some countries, the correlation between both measures is relatively high, but there are noteworthy differences. The unemployment *ratio* suggests that Sweden has a bigger problem than Italy, even though the Swedish youth unemployment *rate* is 12 percentage points lower.

High correlation between rate and ratio

3

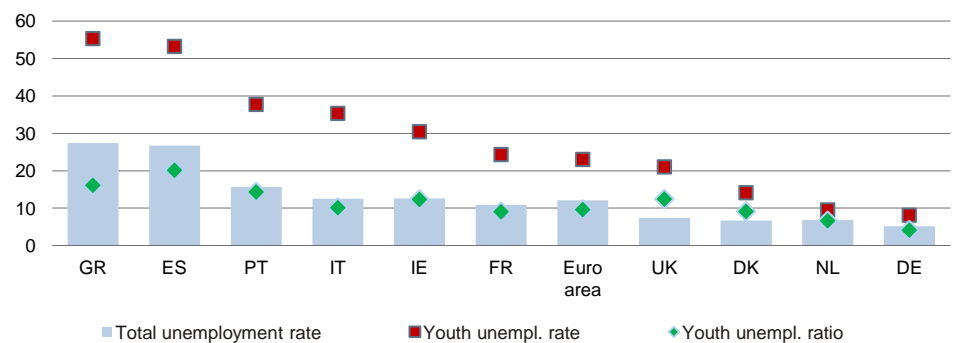
X-Axis: Youth unemployment rate, in %
Y-Axis: Youth unemployment ratio, in %



Sources: Eurostat, Deutsche Bank

Youth unemployment: rate or ratio makes a difference

4



Source: Eurostat

The under-25s will generally have one of the following possible labour market statuses: if they are economically active they are either employed or unemployed. If they are economically inactive it is because they are in education or professional training, or they are so-called "discouraged workers" who are not actively looking for work.² The distribution across statuses changes with age. The majority of the young are in education or training, but at the age of 30 less than 5% are in full time education and at the same time inactive.

Labour market status options for the 15-24-year-olds

Economically active		Economically inactive		
Employed	Registered as unemployed	In education or training: voluntary	In education or training: involuntary (i.e. otherwise unemployed)	"Discouraged" and not looking for work

Some of those who remain in education do so "involuntarily". These are individuals who experience (or anticipate) severe problems to find a job and who chose to remain in education in order not to become unemployed even though they would have preferred to work. While those who "involuntarily" remain in

¹ See Barslund, M. and D. Gros (2013), CEPS Policy Briefs, "Unemployment is the scourge, not youth unemployment per se: The misguided policy preoccupation with youth."

² Note that according to the definition of Eurostat, people are classified as employed or unemployed irrespective of whether they are in education or not. This means that some of those who are in education or training are counted as unemployed (around 1-2% of the age group) or employed.



Who is Europe's "lost generation"?

education avoid a potentially "scarring" unemployment spell, they are pursuing education beyond the level they would otherwise find reasonable and economically beneficial. Had they not decided to opt for education, the number of unemployed young people would be even higher. For this reason, the unemployment *ratio* is biased downwards. As a result, when assessing the labour market effects of the current crisis on the younger generation we are dealing with the problem that we have two inaccurate measures at hand: the youth unemployment *rate* is artificially high, while the youth unemployment *ratio* is artificially low.

In addition, there are a few other distorting factors which complicate a comparison of youth unemployment with older age cohorts: (i) Youth unemployment suffers from a selection bias because those with low qualifications or abilities are less likely to study and more likely to be in the labour force. This type of selection bias vanishes when all members of the age group join the labour force. (ii) For those older than 25 it becomes increasingly unattractive to revert to full-time education instead of becoming registered as unemployed – also because unemployment benefit entitlements will be lost. (iii) The evolution of labour force participation differs across age groups. Especially as a result of rising retirement ages, the labour force participation of older workers has increased in the euro area over the past five years, while it has remained stable or gone down slightly for younger cohorts.³

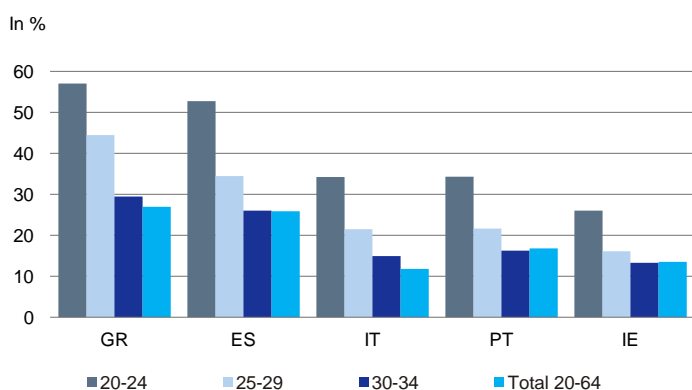
In order to gauge the true effect of the current crisis on different generations it is thus worth looking at the mirror image of unemployment – the share of a cohort which is in employment. This number is less likely to be distorted because when unemployment is high, most persons should find it unappealing to give up their current job and return to education.

Unemployment decreasing with age until the early 30s

When looking at unemployment rates by five-year age intervals, we can identify a common pattern: the unemployment rate for the 20-24 group is higher than for 25-29, which in turn is higher than for the 30-34 group. The absolute difference between cohorts is positively related to the overall unemployment rate. It is largest for Greece and Spain, followed by Italy and Portugal. In countries with low unemployment, there is almost no age difference because high demand for labour makes it comparatively easy for inexperienced workers to enter the labour market. However, this also reflects the better labour market matching via dual training systems in Germany, Austria and the Netherlands.

GIIPS: unemployment highest for those below 30

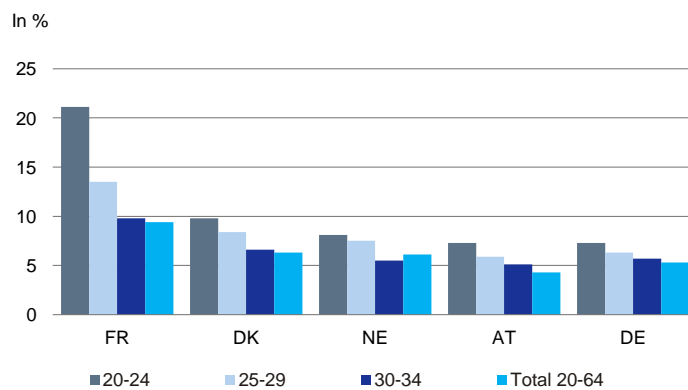
5



Sources: Eurostat, Deutsche Bank Research

Low age gap in countries with low unemployment

6



Sources: Eurostat, Deutsche Bank Research

³ See for example "Recent developments in labour market participation in the euro area." ECB Monthly Bulletin, November 2013.



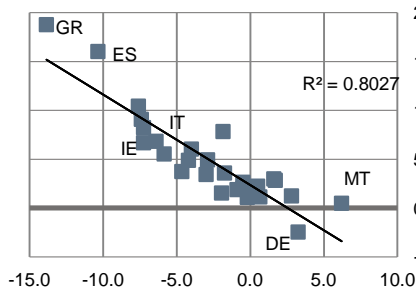
Who is Europe's "lost generation"?

Employment rates: the other side of the coin?

25-59 years: employment and unemployment highly correlated

7

X-axis: Change in employment rate 2008-2013
Y-axis: Change in unemployment rate 2008-2013
 $y = +2,345 - 0,9276x$

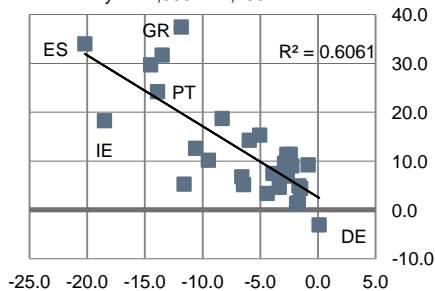


Sources: Eurostat, Deutsche Bank Research

15-24 years: larger impact on unemployment, but lower correlation

8

X-axis: Change in employment rate 2008-2013
Y-axis: Change in unemployment rate 2008-2013
 $y = +2,5937 - 1,4532x$



Sources: Eurostat, Deutsche Bank Research

Generally, there is a very high negative correlation between employment and unemployment rates, but it varies across age groups. For those aged between 15 and 24 both the increase in unemployment and the decrease in employment since 2008 were substantially larger than for the core labour market ages, but the correlation between both is actually smaller. For those aged between 25 and 59 years, a 1 percentage point decrease of the employment rate was linked to an almost identical increase of the unemployment rate. By contrast, a 1 percentage point lower employment rate of the under-25s coincided with an increase of the youth unemployment rate by 1.45 percentage points. Thus, the youth unemployment rate reacted more strongly to absolute changes in employment. The higher observed correlation between employment and unemployment rates in the core labour market age reflects that this group has very few alternatives in case of unemployment, while those under 25 can more easily opt to stay longer in education or to receive additional training.

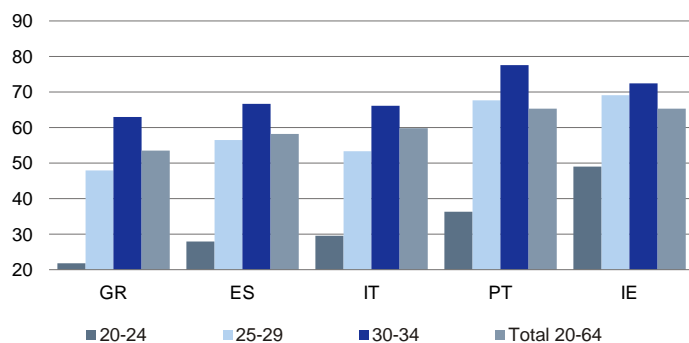
While the unemployment rate rose during the crisis, the overall employment rate decreased in the majority of the European countries. For the euro area as a whole, the average employment rate for those aged between 25 and 59 fell by 2.5 percentage points since 2008. The largest drops were recorded in Greece and Spain at more than 10 percentage points. Only a few countries, for example Germany, Luxembourg and Poland, were able to raise the employment rate. Malta recorded the largest increase, but from the lowest level (in 2008, it was 10 percentage points below the EU average). In almost all countries the main positive contribution came from a higher participation rate of workers above 50.

The bleak situation in the stress countries is also reflected in the evolution of employment rates. The employment rate of those aged between 20 and 24 is a long way below 40% in Greece, Spain, Italy and Portugal. In Austria, Denmark, the Netherlands and Germany, by contrast, it is higher than 60%. Moreover, in most of the central European countries the employment rate of the 25-29 age cohort is higher than the overall employment rate between 20 to 64 years, while it is lower in Spain, Italy and Greece. Across all countries, the employment rate of the cohort between 30 and 34 is higher than the overall rate, which suggests that the disproportionate problems of younger generation in the euro area periphery do not seem to persist beyond the age of 30.

GIIPS: low employment rates, especially below 30

9

2013, %

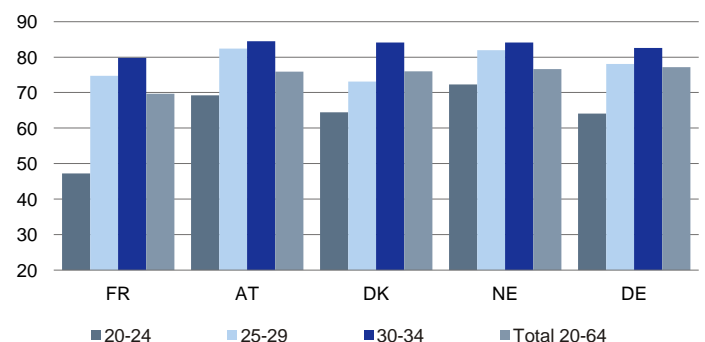


Sources: Eurostat, Deutsche Bank Research

Low differences across age groups in non-stress countries

10

2013, %



Sources: Eurostat, Deutsche Bank Research



Who is Europe's "lost generation"?

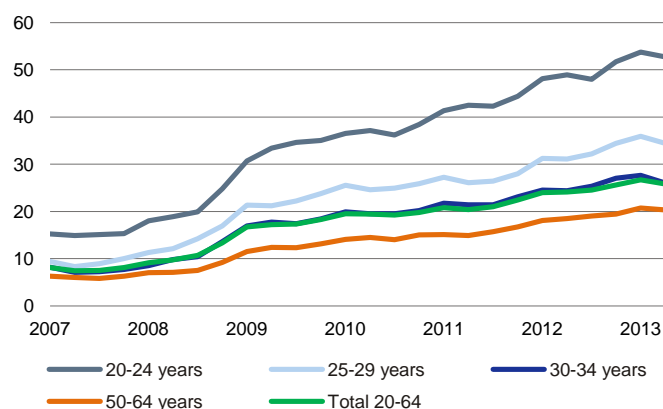
The evolution of (youth) unemployment during the crisis

Spain and Greece have the highest overall unemployment rates and the highest rates among the youth, but the divergence of labour market conditions for younger and older workers followed different paths. The comparison between both countries is illustrative because they had exactly the same overall unemployment rate of 8.3% in 2007. However, the dispersion across age groups was much larger in Greece where even in good times the youth unemployment rate was more than 20%. By contrast, above the age of 25 there was no discernible difference in unemployment rates in Spain in 2007 (see chart 11). It thus appears that the worsening employment prospects of younger cohorts in Spain can be largely ascribed to the crisis and the bursting of the housing bubble, while structural factors seem to play a much larger role in Greece.

Spain: widening age gap

11

Unemployment rates, %

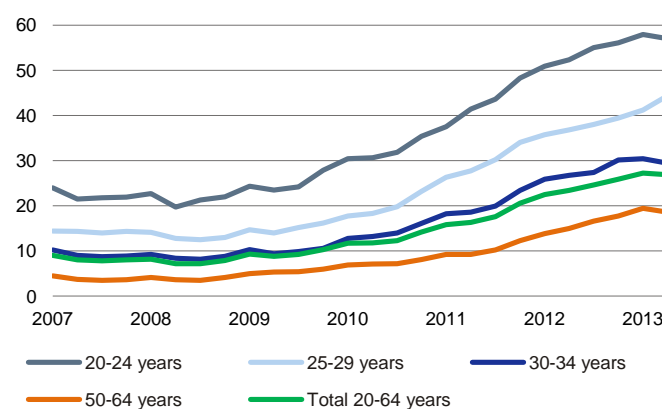


Sources: Eurostat, Deutsche Bank Research

Greece: unemployment of under-30s not a crisis phenomenon

12

Unemployment rates, %



Sources: Eurostat, Deutsche Bank Research

An interesting aspect is that the unemployment rate for older workers between 50 and 64 is much lower than the average for the population aged between 20 and 64. On the one hand, this suggests that older workers are hit less hard by the crisis. On the other hand, as with the very young below 25, older workers close to retirement age are a difficult comparison group because they have an alternative (early-retirement) which is not available to middle-aged workers and because retirement regulations differ across countries. This is another reason why it makes sense to look at employment rates in addition.

(Un)employment trends in core and periphery

As the structural participation rate and the availability of alternatives (e.g. continued (higher) education, extended childcare leave, early retirement schemes) differ across age groups, the most informative way to assess the labour market impact of the crisis is to look at changes in employment and unemployment patterns across cohorts. Here, notable differences become apparent – both between core and periphery and across the stress countries.



Who is Europe's "lost generation"?

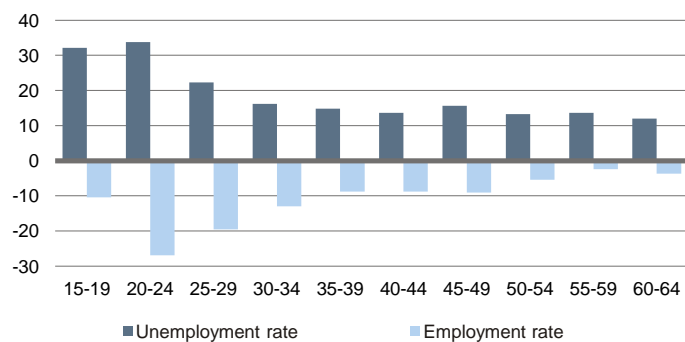
Greece, Portugal and Spain: all lose, but not to the same extent

In Portugal and Spain, the unemployment rate for the young increased by roughly twice as much as for the overall population. From age 30 until retirement, the unemployment rate increased uniformly – by 10-15 percentage points in Spain and 8-10 percentage points in Portugal (see charts 13 and 14). Both subgroups of the reference population for youth unemployment – 15-19 and 20-24 year-olds – registered a similar increase. However, the employment rate reveals that the under-20s account for only a very small share of employment losses, while the employment rate for the 20-24 age cohort fell by 20 percentage points in Portugal and by even 27% in Spain. A particularly large reduction in employment can also be observed for the 25-29-year-olds, and in Spain also for those in their early thirties. Unemployment also increased for workers above 50, but less than the average. At the same time, total employment in this group remained almost unchanged, which can be explained by an increase in the participation rate of older workers.

Spain: employment decreased strongest for 20-34 years-olds

13

%-point change in unemployment and employment rates since 2008:Q2

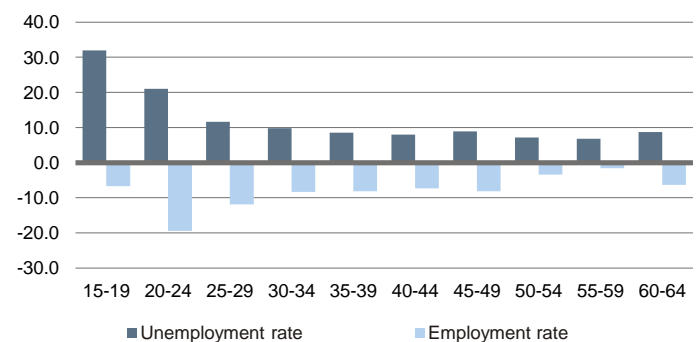


Sources: Eurostat, Deutsche Bank Research

Portugal: (un)employment effects mainly confined to below 30

14

%-point change in unemployment and employment rates since 2008:Q2



Sources: Eurostat, Deutsche Bank Research

In the case of Greece, the picture is broadly similar but it is remarkable that the population segment with the largest absolute employment rate decrease (-25%-points) is the age group between 25 and 29, of which now slightly less than 50% are employed. By contrast, the corresponding employment rate in Austria or the Netherlands is more than 80%. For all five-year cohorts between 20 and 55, the employment rate in Greece dropped by more than 10 %-points.

Greece: largest employment drop between 25 and 29

15

%-point change in unemployment and employment rates since 2008:Q2



Sources: Eurostat, Deutsche Bank Research



Who is Europe's "lost generation"?

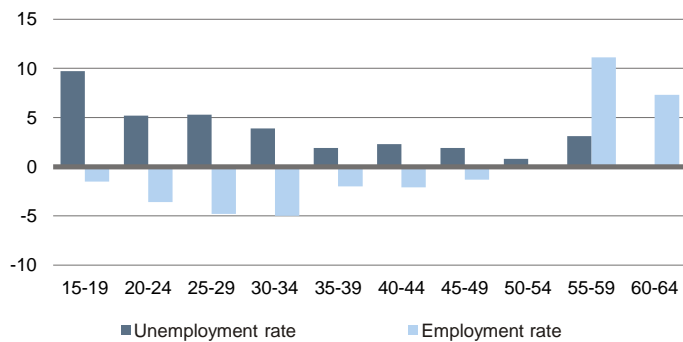
France and Italy: Very mixed impact across generations

Both France and Italy are striking examples of diverging developments in labour market conditions for younger and older workers (see charts 16 and 17). In a remarkably similar fashion, both the rise in unemployment and the drop in employment in these two countries were almost exclusively confined to those below 35. In Italy, the employment rate of this group fell on average by 10%, while it increased by the same amount for those aged between 55 and 59 years in both countries, and by somewhat less for the over-60s. The higher labour market participation of workers above 55 in Italy and France is a positive development, but it occurred from a low base. At slightly less than 25% the employment rate of those aged between 60 and 64 in both countries is still almost 10 percentage points below the euro-area average.

France: fewer young and more older workers

16

%-point change in unemployment and employment rates since 2008:Q2



Sources: Eurostat, Deutsche Bank Research

Italy: employment drops below 35, but rises above 55

17

%-point change in unemployment and employment rates since 2008:Q2



Sources: Eurostat, Deutsche Bank Research

Germany: Job miracle + pension reform = employment growth

The remarkable development of the German labour market during recent years is reflected across all age groups. Since 2008, unemployment has decreased for all cohorts, while employment has increased for all except for the youngest group, which is mainly due to an increase in university attendance. The largest employment increases occurred for workers above 55, which is mainly the result of the far-reaching pension reforms under Chancellor Schroeder ("Agenda 2010"). At around 50%, the current employment rate of 60-64-year-olds is now almost 15 %-points higher than it was in 2008.

Germany: job miracle + pension reform

18

%-point change in unemployment and employment rates since 2008:Q2



Sources: Eurostat, Deutsche Bank Research



Who is Europe's "lost generation"?

Relative unemployment as an indicator of structural problems

Relative unemployment rates, i.e. the unemployment rate for a specific labour market segment divided by the total unemployment rate, are informative about structural labour market rigidities. They demonstrate that the current crisis only amplified existing inequalities. In fact, the ratio of the unemployment rate for those below 25 divided by the rate for the total population is remarkably stable over time – even in countries such as Spain or Greece where the unemployment rate tripled in just five years.

Between 2005 and 2013, the unemployment rate of the 20-24 age group was on average twice as high as for the entire population between 20 and 64 in Europe – by a factor of 2.0 in the euro area and by a factor of 2.1 in the EU. However, cross-country differences are huge. The long-term average for Germany is 1.4 – even during the mid-2000s with a double-digit unemployment rate. The Netherlands, Austria, Denmark and the Baltic countries range between 1.5 and 1.8. The largest inequality can be found in Italy where the youth unemployment rate is three times higher than the overall rate. In Greece and France the likelihood of being unemployed is almost 2.5 times higher for young workers than for the entire population. In Portugal the relative youth unemployment rate has gone up since 2011 while in Spain it remains remarkably constant and close to the euro area average of 2.0.

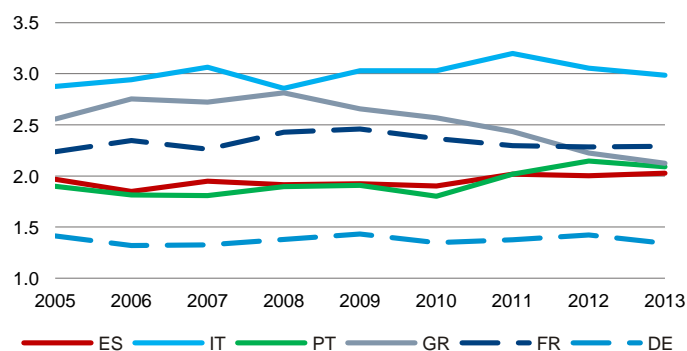
A similar – but not identical – picture emerges when we consider instead the relative incidence of unemployment among 25-29-year-olds (see chart 20). In the better performing countries (again Germany, the Netherlands and the Baltic countries) the unemployment rate for this age group is almost identical to the average, and the ratio is thus close to 1. The upper bound is again defined by Italy and Greece, while France seems to be more successful in absorbing this age cohort into the labour market. Again, the performance of Portugal and Spain is not significantly different from the EU and the euro area as a whole, and Ireland is in fact better than the average.

This demonstrates that high youth unemployment is not the result of a crisis-driven deterioration in their employment prospects relative to older workers. Instead, it can be explained by the fact that they are structurally more affected by rising unemployment than older workers. This holds for all European countries to varying degrees, but Ireland, Portugal or Spain do not perform worse in this respect than, for example, Belgium, France or the UK.

Relative unemployment: 20-24 vs 20-64

19

Unempl. rate 20-24 yrs / unempl. rate 20-64 yrs

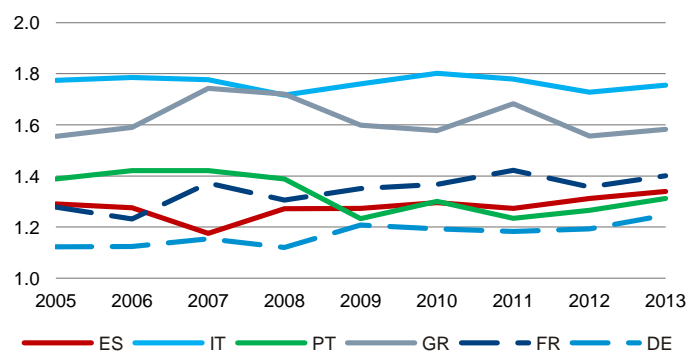


Sources: Eurostat, Deutsche Bank Research

Relative unemployment: 25-29 vs 20-64

20

Unempl. rate 25-29 yrs / unempl. rate 20-64 yrs



Sources: Eurostat, Deutsche Bank Research



Who is Europe's "lost generation"?

The real problem: long-term unemployment

When job creation dynamics are weak, also the share of long-term unemployed (defined as an unemployment spell of more than 12 months) increases. On the one hand, this reflects the longer duration required to find a job due to a scarcity of employment opportunities. On the other hand, high unemployment changes the composition of the pool of jobless because also better qualified workers and recent university graduates are increasingly out of work. They often have to accept jobs for which they are overqualified. This, in turn, makes it even more difficult for those with a low qualification profile to return to employment.

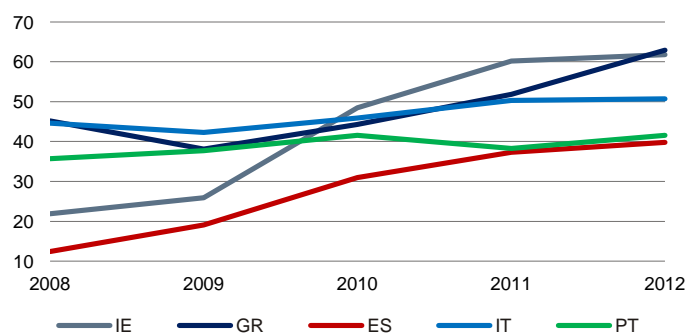
The rising share of long-term unemployment is of particular concern because the probability of finding a job decreases with unemployment duration. Therefore, this group will be the most difficult to re-integrate into the labour market. Ireland and Spain both had a remarkably low share of long-term unemployment before the crisis, also because the booming housing markets generated an unusually high demand for low-skilled workers for the construction sector and related industries. However, the share of long-term unemployed of total unemployment has climbed by around 30 percentage points since 2008.⁴

While the proportion of long-term unemployed continues to be higher among older workers, it has been rising steeply for the young. In Spain, the long-term unemployed aged below 35 accounted for less than 15% of total unemployment in that age group during the boom years, but this share has more than doubled since (see chart 22). In Ireland and Greece, 60% of those between 25 and 29 without a job have been unemployed for more than 12 months.

25 - 29 years: long-term unemployment rising steeply

21

Unemployed for > 12 months, in % of total unemployed between 25 and 29

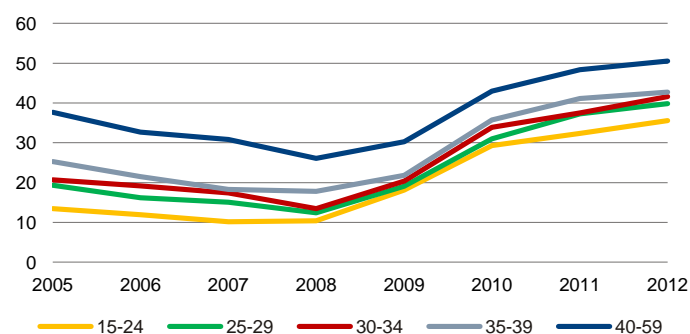


Source: Eurostat

Spain: long-term unemployment of the young is becoming prevalent

22

Unemployed for > 12 months, in % of total unemployed in the age cohort



Source: Eurostat

Does educational attainment make a difference?

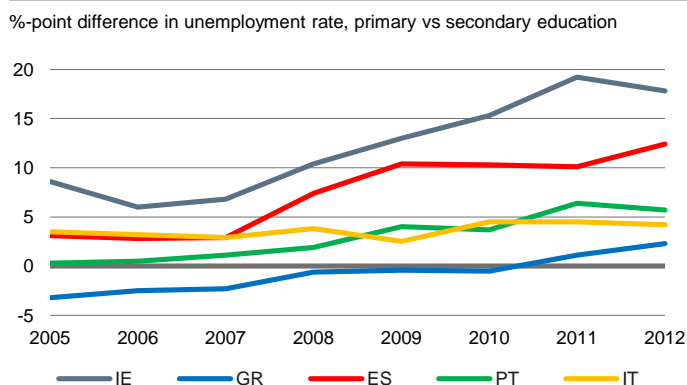
Higher educational attainment does not guarantee better job prospects, but in some countries there is clearly an "education premium" in the sense that unemployment is lower for those with a higher level of education. Although to varying degrees, the unemployment risk for the low-skilled has increased more than for medium- and high-skilled workers. Charts 23 and 24 display the difference in unemployment rates between those who have no more than primary education and those with completed secondary or tertiary education.

⁴ Before the outbreak of the crisis, the country with the highest share of long-term unemployed was Germany, with almost 60% in 2006. The gradually improving labour market has helped bringing down the structural long-term unemployment to slightly below 50%.



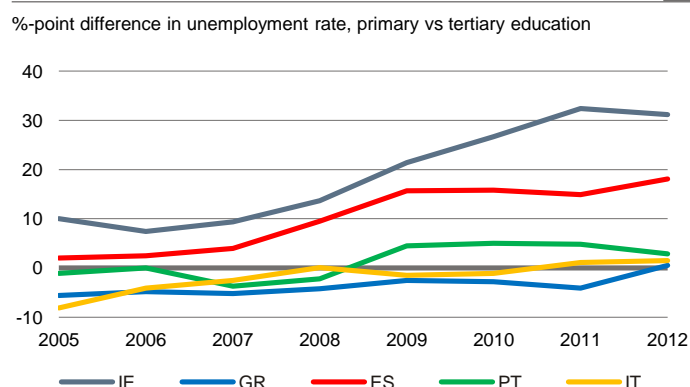
Who is Europe's "lost generation"?

Unemployment difference by education levels is widening 23



Sources: Eurostat, Deutsche Bank Research

Tertiary education reduces unemployment risk only in Ireland and Spain 24



Sources: Eurostat, Deutsche Bank Research

Especially in Ireland and Spain, the gap has widened significantly. In Ireland, the unemployment rate of those with no more than primary education is more than 20 (30) percentage points higher than for those with secondary (tertiary) education. In Spain, a discernible education difference has evolved only during the crisis years, but continues to widen. By contrast, the education level does not have a very strong impact on the likelihood of becoming unemployed in Greece, Italy and Portugal.

Micro- and macroeconomic implications

The economic costs of high unemployment of younger cohorts extend far beyond the individual costs due to forgone earnings. Unlike the simplistic emphasis on youth unemployment would suggest, most crisis countries registered a particularly large drop in employment rates for those aged between 25 and 34. The disproportionate impact on this age bracket is problematic for a variety of reasons. For the over-25s it is more difficult, and generally less useful, to return to higher education, and longer periods of unemployment have persistent negative effects on earnings. Unlike the under-25s, they may have already taken some large-scale investment decisions (the average house buyer's age in Spain was 35 in 2008 and 33 in 2009)⁵, which will be difficult to finance during unemployment and raise the risk of indebtedness. The inability to meet one's debt repayment obligations has repercussions for the banking sector because it increases the share of non-performing loans and exacerbates systemic risk in the financial sector.

There are also demographic implications of persistent unemployment in young cohorts. Birth rates in Greece, Italy, Portugal and Spain were among the lowest in Europe even before the crisis, but they have fallen further, in contrast to most other EU countries where they have recently stabilised. In addition, the disproportionate fall in employment for the young excludes many well-trained individuals from the labour market and results in an ageing workforce which in turn has a depressing effect on aggregate productivity and GDP growth. A realistic estimate is that Italy and Spain experienced an adverse productivity shock of around -2.5% since the beginning of the crisis, which is likely to reduce potential output by 0.2-0.3 %-points over the next five years.⁶

⁵ <http://www.idealista.com/news/archivo/2009/09/04/098926-compradores-pisos-son-cada-jovenes>

⁶ For a detailed discussion see "Insight Europe: Reform of Regress", Deutsche Bank, June 2013.

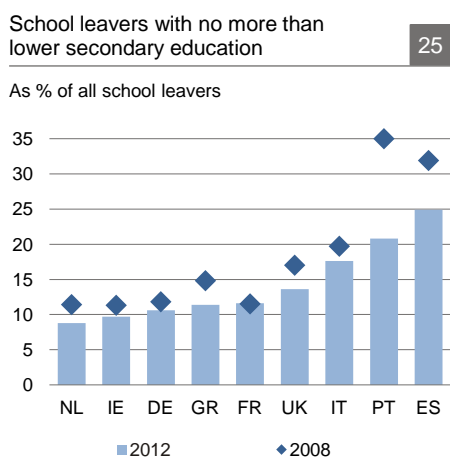


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Policy interventions and structural reforms

The European Commission and the member states have endorsed a "youth guarantee" in April 2013, with the aim of providing all under-25s with an employment or training opportunity within four months after leaving education or becoming unemployed. However, in light of the large employment decline among 25-34-year-olds, the restricted focus on the under-25s appears unwarranted. A better inclusion of young cohorts requires preventive efforts to enhance the employability of school-leavers and reduce structural inequalities between younger and older workers, but also a variety of active labour policies to bring those who are currently unemployed back into work.

Preventive measures and structural reforms:



- **Better employability of school-leavers:** Individually, the best insurance against unemployment is a good education level and a broad set of skills. Some countries have pursued a strategy of maximizing the share of university graduates, but what really matters is to reduce the number of those who leave the education system with a very low qualification.⁷ The share of early school-leavers in Spain and Portugal is still above 20%, and not much lower in Italy. Even though these countries made significant progress during recent years, their education systems need to be equipped to further reduce the share of potentially vulnerable school leavers.
- **Reduce duality between permanent and temporary contracts:** If permanent contracts offer a very high degree of employment protection, companies have incentives to use temporary contracts in order to gain more flexibility, and to not extend temporary contracts if otherwise they convert into permanent contracts. As a high share of young workers in the euro area periphery start with a temporary contract, the adjustment during the economic downturn consequently mainly fell on them. Therefore, the gap in terms of labour costs and employment protection between temporary and permanent contracts needs to be reduced. This requires a reduction of excessive protection levels and severance pay for permanent workers, in some cases combined with better protection for temporary staff to make it unattractive for companies to rely too heavily on temporary contracts.
- **Facilitate labour market entry by reducing costs for hiring beginners:** The skills and productivity of workers increase strongly during their first years in a job. Thus, given identical wage costs, companies quite understandably have a preference for hiring a worker who already has some professional experience over someone without a prior work history. Thus, companies need financial incentives for hiring young workers without job experience and investing in their skills acquisition. In the vocational training system that is predominant in central Europe, apprentices earn only a fraction of what older workers receive during the first few years. Policies which prevent companies from discriminating between experienced and inexperienced workers will inevitably be to the disbenefit of the latter. Therefore, an identical minimum wage for workers across all age groups is such a detrimental measure, and it will make the labour market entry of medium-to-low qualified school leavers particularly difficult.
- **Improve the match between supply and demand for workers:** A striking feature of almost all crisis countries is that while they produce a relatively high share of university graduates, there is a lack of adequate jobs. At the

⁷ See also "You can't teach an old dog new tricks – or can you?" Stefan Vetter and Lilian Sachtleben (2013). In Deutsche Bank Research, Focus Germany, Nov 29, 2013.



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same time, there is often a shortage of well-trained professionals. Better developed vocational training systems would help to meet the demand for qualified professionals. In addition, in order to increase the attractiveness of vocational training, the possibility of combining professional and academic education should be improved, for example by offering more tertiary degree programs specifically designed for professionals with prior work experience.

Activation policies to facilitate integration of younger cohorts

The above-mentioned measures would contribute to a reduction of the structural inequality between younger and experienced workers, but visible effects would materialise only in the long run. The exceptional situation in the crisis countries also calls for measures with an immediate impact, where the main objective should be to prevent young job-seekers from falling into the long-term unemployment trap. As these measures are costly, they should be the priority of additional financial support by the EU. Possible sources of EU funding include the European Social Fund (ESF), the additional funds made available by the youth employment initiative, but also structural funds which can be more actively targeted towards employment policies.⁸

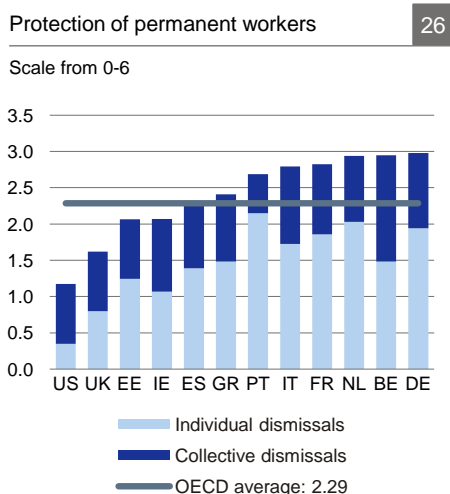
- **Subsidize youth employment, especially contracts with training content:** All stress countries have implemented some kind of subsidy for businesses which hire young job-seekers, usually in the form of a reduction of the employer's social security contribution by 50-100% for a limited period. These employment subsidies should be differentiated according to the training content of the job. In this way, employers would have an incentive to contribute to the skill formation of young jobholders. At the same time, such a differentiation would reduce the risk that these contracts are mainly being used to substitute regular contracts in occupations with a low skill profile.
- **Mobility grants and support for job searching abroad, and sponsoring of measures to improve employability:** The flipside of the extreme labour market disparities within the EU is that there are also countries with very robust employment developments. In seven EU countries, among them Austria, Germany, Denmark, the overall unemployment rate is currently below 7%, and in some sectors there is even a shortage of qualified staff. An effective way to help job-seekers in the crisis-stricken countries is to offer support for the job search abroad, including financial support such as mobility grants and subsidized language courses for successful applicants.
- **State-sponsored temporary employment for those at risk of becoming long-term unemployed:** Given that the public sector in most euro area periphery countries was rather too large before the crisis, sustainable employment growth will inevitably have to come from the private sector. However, fiscal adjustment during the crisis also affected key areas, for example education and healthcare, where more investment would be needed in the long-term. Governments could create temporary positions for young job-seekers with little or no work market experience in those sectors, guided by the aim of providing unemployed youth with some initial job experience. They should be limited to a period of one year and eligibility should be restricted to those at risk of becoming long-term unemployed (for example those who are unemployed for more than 6 months). A salary equivalent to the national minimum wage for that age group would ensure that beneficiaries still have an incentive to search for regular employment, but also limit the budgetary impact as the additional cost is only the difference between the minimum wage and the unemployment benefits.

⁸ See also "EU measures to tackle youth unemployment". EU Commission Memo, November 2013.



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Reform progress: a mixed picture



Source: OECD

The OECD recently concluded an extensive review of the labour market reform undertaken by the Spanish government in 2012 with a generally favourable assessment. The reform has contributed to an increase in the flexibility of firms and significant wage moderation. The reduction of excessive dismissal costs will make hiring on permanent contracts more attractive. In the long run, the OECD expects productivity gains of ¼ percentage point annually. However, severance pay for experienced workers remains among the highest in the OECD.⁹

While it took several years until labour costs in Greece started to decline noticeably, they have been falling significantly since 2011. A contributing factor was the reduction of the minimum wage, and the minimum wage for the under-25s is now some 13% lower than for the over-25s. However, the OECD concluded that the rise in unemployment, especially for the young, has not been adequately matched by activation policies and that the effectiveness of the job-search monitoring system should be strengthened by linking unemployment benefits to stricter obligations in employment and training schemes.¹⁰

Despite a reduction in dismissal costs, Portugal still has the highest level of protection for permanent workers against individual dismissals in the OECD (even though the highest total level of protection can now be found in central Europe). In France and Italy, where the degree of structural inequality between young and old workers is at least as pronounced as in Spain, comparable reforms have not been tackled. The high minimum wage in France remains an obstacle for inexperienced applicants, and in particular for the less qualified among them. Italy needs to strengthen its education and vocational training systems and improve the effectiveness of its job-search institutions.

Outlook

The fundamental challenge for the years to come will not only be to create new jobs, but also to improve the conditions for those who will enter the labour market during the coming years and to find ways to (re-)integrate an unprecedented number of (long-term) unemployed workers with little or no job experience in an increasingly demanding work environment.

For the countries hardest hit by unemployment, the crisis offers an opportunity to fix some of the persistent structural rigidities and labour market inequalities against much less public resistance than during less exceptional times. If properly done, these countries could exit the crisis with more inclusive labour market institutions than before. However, the limited reform progress in some areas might still reflect an underestimation of the detrimental long-term impact of extended unemployment on a whole generation of young adults.

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⁹ See OECD, "The 2012 labour market reform in Spain: A preliminary assessment", December 2013.

¹⁰ See OECD, "Economic Survey of Greece 2013", November 2013.



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