

Do baby booms lead to employment busts? Not in OECD countries

The post–World War II OECD baby boom offers lessons on how to absorb large youth cohorts into the labor market. What groups are most affected? What policies help youth most? Do bad policy choices cause more damage to youth employment prospects than large youth populations?

Youth unemployment in OECD countries is due to weak demand and bad policy and not the baby boom

One year after the end of World War II and for about 20 years thereafter, the G-7 countries experienced a surge in the birth rate relative to periods before and since. As a result, an unusually large share of youth entered the labor force from the mid-1960s until the early 1980s, with the peak occurring between 1967 and 1973 (figure 1). Since then, the youth share of the labor market has fallen steadily.

One might expect that youth in the baby boom cohorts would have had much more difficulty finding work than would the relatively small youth cohorts entering the labor market in the 1990s. The opposite is true, however: average youth unemployment rates across the G-7 countries are 7 percentage points higher than during the peak of the baby boom. In contrast, adult

unemployment rates in the G-7 countries have risen less than 2 percentage points.

Youth unemployment rates did rise modestly as the baby boom cohort entered the labor market. However, the unemployment rates are affected much more by the overall strength of the labor market.¹ Youth unemployment is extremely sensitive to the business cycle: youth benefit greatly when labor demand is increasing, but suffer disproportionately when the economy is in recession or growing slowly. One lesson from the Organisation for Economic Co-operation and Development (OECD) countries is that even a modest deterioration in the strength of labor demand, measured by the rising unemployment rate for older workers in OECD countries, has increased the difficulty in the transition from school to work.

The less educated and minority youth have the greatest problems with unemployment

Are youth receiving too much education so that they become overqualified for the jobs that are available? No. Evidence suggests that the least educated face the greatest mismatch between skills and job vacancies. In almost every industrial economy, average unemployment rates fall as years of schooling increase.

Nor does job training tend to reduce the disadvantage faced by the less educated. The gap in access to jobs continues as the cohorts age because the most educated get the most job training. College graduates in OECD countries are seven times more likely to receive training than are high school dropouts. Similarly dramatic gaps in access to training exist between the highest and lowest literacy groups.

Unemployment rates are uniformly higher for minority youth in OECD countries. Such groups are atypically disadvantaged by recessions and by policies that tend to limit new job creation. They are also atypically disadvantaged in completing edu-

cation, compounding disadvantages related to discrimination in the labor market. In France, where government statistics do not recognize ethnicity, youth unemployment rates in predominantly ethnic urban enclaves are around 40 percent, nearly twice the already high French average.

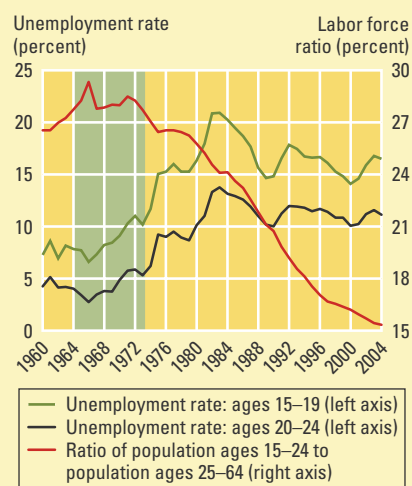
High youth unemployment can cause youth and the country permanent harm

Does early unemployment cause permanent scarring of youth, resulting in employment difficulties later in life? Answers vary. In the United States, most studies find that spells of unemployment after leaving school do not result in persistent unemployment later in life. This corresponds to fairly high transition rates from unemployment into employment: 46 percent of unemployed youth are employed one month later.

Corresponding transition rates in France, Germany, and the United Kingdom are much lower, ranging from 4 to 14 percent, and more evidence indicates that early unemployment results in persistent unemployment. One-third of the unemployed in France have been unemployed more than a year, compared with 8.5 percent in the United States. The persistent adverse effects of early unemployment on later employment stability can last seven years in France, compared with two in the United States.² The degree of persistence appears to respond to business cycles, with less permanent damage from early unemployment in economies experiencing job growth. In addition, the scarring effect of early unemployment tends to be greatest for the least educated and for disadvantaged youth.³

Weak youth labor markets tend to delay other transitions. In Europe, the average age at which youth leave the home has increased, especially in southern European countries. In Italy, 80 percent of males ages 18–30 still live with their parents, compared with 25 percent in the United States. Across OECD countries, the average age of marriage has

Figure 1 Youth unemployment rates for the G-7 countries are higher now than during the baby boom



Source: Authors' compilations based on data provided by OECD Database on Labour Force Statistics.

Note: Shaded portion of the figure indicates peak baby boom entry years.



increased while the average number of children per household has fallen.

Weakening youth labor markets have at least a partial role in explaining these changes in life transitions. Youth tend to delay leaving their parents' homes during recessions. Differences in the relative strength of country youth labor markets can explain observed differences across countries in the average age of home leaving.⁴ In Germany and Spain, the likelihood of leaving home increases significantly with youth employment status and labor earnings.⁵

When youth face constraints in access to legal employment, they may engage in illegal activities. Studies in the United States and the United Kingdom show that weakening wages for low-skilled youth are correlated with increases in criminal activity.⁶ Less consistent evidence links long-term youth unemployment with crime, although discontent with high rates of youth unemployment in minority communities has been cited as a contributing factor to unrest. One recent study in France shows that cities with higher youth unemployment have higher rates of burglaries, thefts, and drug offenses.⁷

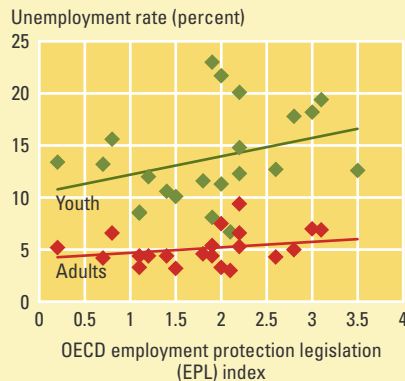
Efforts to protect job security do not help and may hinder youth

The youth unemployment problem appears to be exacerbated by policies aimed at preserving jobs. Many countries have enacted Employment Protection Legislation (EPL) that makes it more difficult or costly for firms to lay off workers. These policies are designed to insure workers against income loss from fluctuations in labor demand. However, such legislation also makes it more costly for firms to hire workers, thus stricter EPL tends to depress the rate of new job creation.⁸

These adverse consequences of EPL are borne mostly by groups that are disproportionately first-time job seekers, so youth tend to be atypically disadvantaged.⁹ Because EPL appears to retard new job creation, it can also heighten the persistent effects of early unemployment on employment prospects later in life.

Stricter employment protection legislation does not appear to create unemployment problems for older workers and may even insulate them from competition with

Figure 2 Employment protection hurt OECD youth, but not adults, in 2003



Source: Authors' compilations based on information presented in OECD (2004).
 Note: In the figure, youth are those ages 15–24; adults are those ages 25–54. Correlation with EPL index is 0.32 for youth and 0.27 for adults. Each data point in the graph represents one country.

younger workers (figure 2). In eras of both large and small youth cohorts, stricter EPL is correlated with higher youth unemployment rates.

Similar findings hold for legislation that diminishes wage flexibility, such as high minimum wages or extending union-negotiated wages to nonunion workers. Such policies reduce wage inequality across workers, but risk making it too expensive to hire those lacking schooling or prior labor market experience.

Many of the countries with the strongest youth labor market outcomes over the past 15 years (Ireland, the Netherlands, New Zealand, the United Kingdom, the United States) have tended to be those with rising wage inequality. The implication is that wage flexibility has helped these economies to adjust to shocks and to create new job opportunities for youth, but at a cost of increased income disparities in the population.¹⁰

Countries with stronger EPL have experienced growth in temporary and fixed-term jobs that are frequently exempt from firing restrictions. This allows new job growth, but it creates dual labor markets with protected jobs held predominantly by “insiders” (older male workers) and temporary jobs held by “outsiders” (women, minorities, and youth). Insiders have an incentive to maintain and expand employ-

ment protection, which protects their jobs at the expense of youth and other outsiders. Perhaps that is why all but a few countries have found it so difficult to relax the employment protection, even when their youth unemployment rates are so high.

Efforts to fix the youth labor market have mixed success

OECD countries have used various policies to try to fix youth unemployment. One option that appears unsuccessful is to try to “make room” for youth employment by encouraging older workers to retire. The limited evidence suggests that older and younger workers may be complements and not substitutes in production. Countries with higher retirement ages for men and women have higher employment rates for male and female youth.¹¹ Similarly, efforts in France to limit hours of work to force firms to hire additional workers appear not to have resulted in appreciable job growth.

The average OECD country spends around 2 percent of GDP on active labor market policies, with training being the largest component of those expenditures. Public expenditures are only about one-tenth of the total, however, and private training is weighted heavily toward the most educated. Private training is unlikely to offer a significant second-chance option for those who failed to attain a sufficient level of prior education. Publicly subsidized training tends to have the greatest success with more-educated recipients.

The experience of youth training programs in Europe suggests that they have improved the transition to employment but that the impact on earnings is more mixed.¹²

Of other active labor market policies, job search assistance and wage subsidies appear to be the most promising for raising employment rates of disadvantaged youth, but public employment programs have not worked. Evidence also suggests that youth are more successful in transitioning to employment in countries where unemployment benefits are conditioned on active job search and willingness to accept jobs when offered.¹³