



Euro, crisis and unemployment: Youth patterns, youth policies?



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ABSTRACT

This paper examines the occurrence of structural breaks in European unemployment associated with major institutional events. We uncover different responses of adult and youth unemployment rates. While adult unemployment is more prone to experience structural breaks, youth unemployment is more sensitive to business cycle oscillations, especially in the recent crisis. This calls for fine tuning policy measures specifically targeted to youth unemployed in bad times. One important implication of our findings is that generic labour market reforms are not effective enough to solve the youth unemployment problem. Educational policies raising average qualifications and helping school-to-work transitions are suitable complementary cures.

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1. Introduction

The Global Financial Crisis has led to a significant increase in unemployment after a long expansionary period. Aggregate unemployment in the European Union was 9.2% in 1999, moved down to 7.2% in 2007, and rose to 10.2 in 2014. In the euro area, it decreased from 9.7 to 7.5 and then rose to 11.6% over the same years. Within the European aggregates, however, there are wide differences in the unemployment behaviour between countries.

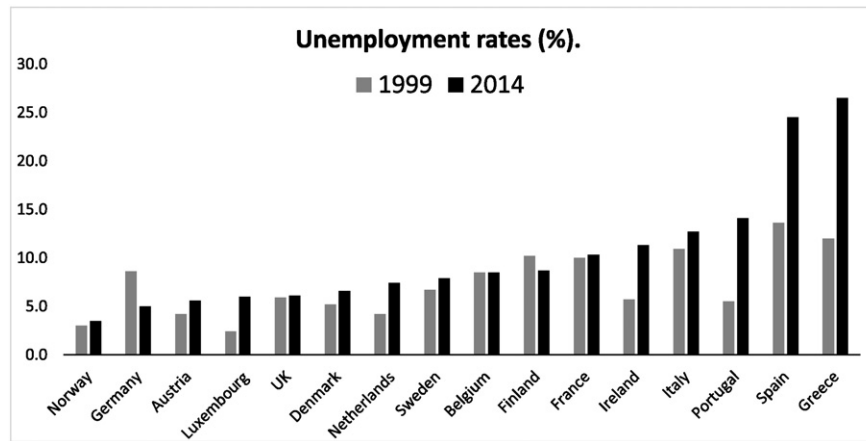
Unsurprisingly, the European periphery countries present the worst unemployment behaviour (Fig. 1). At the start of the EMU, for example, Greece and Spain had unemployment rates around 12 and 14%, not far away from the 9% in Germany in 1999. Since then, however, while in the Scandinavian and continental European countries unemployment rates have hardly changed across expansion (1999–2007) and crisis (2008–2014), they have doubled in the periphery (Ireland, Portugal, Spain and Greece).

These developments have raised concerns about the persistence of high levels of unemployment (OECD, 2011, 2014) and its social and economic consequences: widespread deterioration of human capital, discouragement and labour market withdraw, effects on government budget and standards of living. These concerns are not however new. The seriousness of the high and persistent European unemployment problem has long been recognized, and countless theoretical and empirical studies have been undertaken to determine its causes (Layard et al., 1991; Bean, 1994; Ljungqvist and Sargent, 1998; IMF, 1999; Blanchard, 2006, among many others).

However, most of these studies focus on the aggregate unemployment rate. As shown in Fig. 2, youth unemployment rates may be characterised by different dynamics. Note, for example, that the rates in 2014 were larger than those of aggregate unemployment in all countries with no exception, both in 1999 and 2014. A second noteworthy feature is that unemployment increases were larger in youth unemployment in all economies with the exception of France and Norway. More precisely, the largest increases in the youth unemployment rate took place in Greece, Portugal and Spain (between 20 and 27 percentage points), followed by Ireland, Italy and Luxembourg (around 15 percentage points), and Sweden (10.6 percentage points). Note that

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Source: Eurostat.

Fig. 1. Unemployment rates (%).
Source: Eurostat.

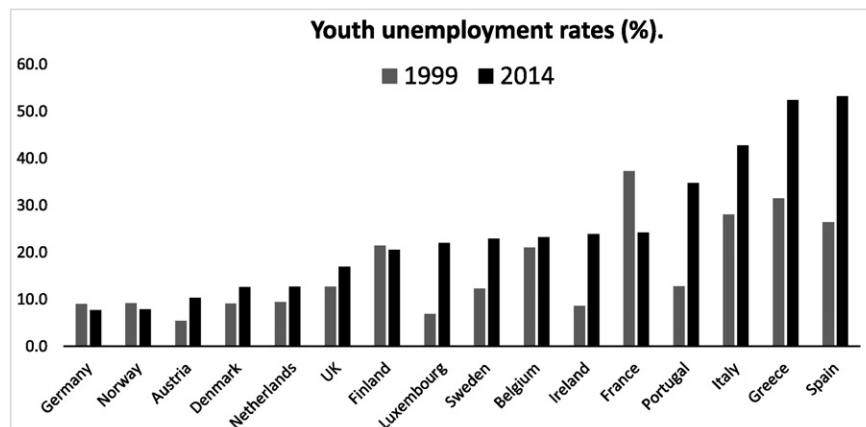
Luxembourg more than tripled its youth unemployment rate, while in Sweden it almost doubled as it did in Austria.

In view of these differences, a disaggregated analysis of unemployment by considering specifically the youth and adult rates may uncover significant specific patterns, and thus be useful to refine some of the generic policy recommendations aiming at the restructuring of the so called unfriendly labour market institutions (employment and unemployment protection legislation, union power, fiscal wedges). This would not imply neglecting such policies, but certainly would call for group-specific measures in case different dynamics exist.

Time series analysis has been widely used to test among unemployment theories. A first wave of studies were concerned with the degree of integration of unemployment series. If unemployment could be characterised as a unit root process, empirical support would be given to the hysteresis hypotheses (Blanchard and Summers, 1986, 1987), under which temporary shocks have permanent effects. At the other extreme, an order of integration close to zero would endorse the NAIRU theory (Layard et al., 1991) according to which shocks cause short departures from equilibrium and policies should focus on lowering this equilibrium rather than reducing persistence (as under the hysteresis hypothesis). A more flexible approach, such as the Structuralist one proposed by Phelps (1994), considered the possibility of infrequent shocks that would cause regime changes in unemployment.

Our study departs from this tradition of unemployment time series analysis (Narayan and Smyth, 2004; Valadkhani and Smyth, 2015) as we take a univariate approach to examine the nature of trends in unemployment of European countries. Our objective, however, is not to contribute to the extant research on unemployment hysteresis, but to measure the trends in unemployment, and disaggregate the analysis by examining youth unemployment as well, which happens to be a contentious issue. This involves detecting whether there is a case of breaking trends and how the trends are measured within regimes demarcated by the break points.

Accordingly, this paper aims at identifying potential breaks in European unemployment due to the occurrence of single definitive events: the settlement of a monetary union in 1999 and the Euro/financial crisis in 2008–2009, which was followed by an intensive and extensive reform process. In this paper we seek to answer pertinent questions such as: Has the adoption of the single currency contributed to the large distribution of unemployment rates across the euro zone area? Has the euro crisis contributed to an increase in structural unemployment? If so, for which countries? The above questions can be analysed by the robust detection and date stamping of structural breaks in unemployment across euro area countries. For example, structural breaks located around the introduction of the euro could appear in peripheral countries, but not in core countries, could be interpreted as a signal that the adoption of the single currency had asymmetric effects on the unemployment behaviour



Source: Eurostat.

Fig. 2. Youth unemployment rates (%).
Source: Eurostat.

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