

## Mario Draghi: Youth unemployment in the euro area

Keynote speech by Mr Mario Draghi, President of the European Central Bank, for the Henry Grattan Lecture Series, Trinity College, Dublin, 22 September 2017.

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First, let me thank the Provost, Patrick Prendergast, for the warm welcome, Professor Gail McElroy for the introduction and indeed Trinity College Dublin.

I am happy to see my friend Philip Lane, Governor of the Central Bank of Ireland. We see each other in Frankfurt every other week so I am pleased to see him in a different setting. It's also nice to see my former colleague Patrick Honohan. And a warm welcome to all of you.

I am especially honoured to speak here in Ireland for the first time and here in this prestigious, world-class institution, Trinity College, Dublin. Many of you are students, and to speak to young people who will carry today's message into tomorrow's world always entails a special responsibility. With it comes the honour of having been chosen to give this address. Your lives are being changed forever by the education of exceptional quality that you are receiving here, in a testimony to the history of Trinity, its birth, its glorious past and its distinguished alumni.

I should especially acknowledge its extraordinary teachers, including Patrick Honohan, former Governor of the Central Bank of Ireland, and his successor Philip Lane.

The Book of Kells, on permanent display here at Trinity, with its history and its beauty, reminds us of the importance of nurturing knowledge, spreading it throughout the world, and protecting it in times of peril. It also tells us how important Ireland and its culture are for Europe.

It is well known how relevant the role of Irish monastic orders was in preserving our European cultural heritage in the early medieval period. At the turn of the 7th century, St. Columban embarked on a journey across Europe. From the Atlantic to the Alps, he founded monasteries which were the centres of learning of his time. Along the way, he urged kings and commoners alike to adopt a notion of a European society rooted in the universal values of human life, the common good and education.

Robert Schuman, a founding father of the European Union, honoured St. Columban in 1950, saying that "this illustrious Irishman who left his own country for voluntary exile, willed and achieved a spiritual union between the principal European countries of his time. He is the patron saint of all those who now seek to build a united Europe."

It is with these thoughts in mind that I have chosen the topic of our meeting today: young people and the labour market in Europe.

### Youth unemployment in the euro area

Youth unemployment is not a recent phenomenon. It was high over the last few decades, driven both by cyclical and long-term structural factors.

In Europe, the worsening labour market performance for young people became apparent in the 1970s, when unemployment increased from 4.6% to 11.1% by the end of the decade, partly due to the substantial increase in supply as the so-called baby-boomers entered the labour market. But even when the size of this group declined, the relative labour market performance did not improve. There was some recovery in the early 1990s, but it never returned to the level of the early 1970s.<sup>1</sup> In 2007, when total unemployment in the euro area declined to 7.5%, its lowest level since the early 1980s, the unemployment rate for young people was already very high at around 15%.

Youth unemployment is not just structural but also highly pro-cyclical. During the Great Recession, and the corresponding cyclical downturn, youth unemployment surged markedly. Between 2007 and 2013, it increased by about 9 percentage points in the euro area – twice as much as the overall unemployment rate.

But euro area aggregates hide important differences across the euro area. Greece and Spain entered the crisis with youth unemployment rates of 23% and 18% respectively, and reached rates well above 50% by 2013. In Ireland, it tripled over the same period, peaking at 30%. In comparison, the youth unemployment rate in Germany, a country less affected by the cyclical downturn, declined from about 12% in 2007 to about 8% in 2013.

What is the situation now? The ongoing economic recovery in the euro area has led to improved labour market conditions. Euro area real GDP has now grown for 17 consecutive quarters, creating in total over 6 million jobs. As a result, from its peak in 2013, the youth unemployment rate fell from 24% to around 19% in 2016, but is still about 4 percentage points higher than at the beginning of the crisis in 2007.<sup>2</sup> In Ireland, where real GDP grew 5.2% last year, it declined by more than 13 percentage points from its peak, and is now below the euro area average.

However, headline unemployment rates give only a partial picture of the labour market situation. Many young people in the euro area are still in education or are not actively seeking employment. The possible significant social and economic consequences are even more relevant if we look at new measures of labour utilisation, taking into account both unemployed people and those not involved in further education or training. In 2016, around 17% of people between the ages of 20 and 24 in the euro area were neither in employment, education or training, with Ireland being close to this euro area average.<sup>3</sup> In Greece and Spain, the numbers are 23% and 21% respectively.

The persistence and heterogeneity of youth unemployment across Member States point to continued underlying problems in labour market structures, with correspondingly high costs for our societies.

### **Long-term costs of youth unemployment**

Cyclical unemployment can turn structural if people remain unemployed for a long time. Protracted periods of unemployment can result in “scarring” effects, leading to a greater likelihood of future unemployment, human capital losses and lower earnings<sup>4</sup>. And this has negative effects not only on life satisfaction, but also on health, and may persist well into later life. The sense of detachment that is produced by prolonged unemployment has been well documented in several social experiments. With a large proportion of young people not having any defined role in society (neither looking for jobs, nor acquiring the skills to find one), there is a high risk of social cohesion and of trust in public institutions being undermined, with harm for medium-term growth prospects.<sup>5</sup>

Youth unemployment is also costly in terms of long-term productivity. High-productivity firms, particularly in their early expansion phase,<sup>6</sup> are more likely to hire young people because that group will help them to become more innovative.

Innovation is driven, among other things, by curiosity and creativity. The fact that young people are more curious requires no further explanation; the teachers among you or those of you with children or grandchildren are well aware of that.

When it comes to creativity, age plays a crucial role. Creativity can be measured, for example, by the number of original and valuable contributions to fields such as science and art. By that measure, output first increases in our mid-20s, reaches a peak when we are in our 30s or early 40s, and then undergoes a slow decline as we age<sup>7</sup>.

So to foster innovation, it is very much in the interest of firms to recruit young people<sup>8</sup>.

The young are also in a better position to facilitate knowledge diffusion. In this regard, labour mobility is key. During the early years of their careers, young workers, in the search for a better job, move more frequently between professions and assignments. As we get older we change jobs less often: at the age of 40 we switch half as much as we do at 20.<sup>9</sup> The mobility of the young is likely to facilitate an efficient allocation of labour through higher job-to-job transitions. And this mobility across firms and sectors, and sometimes across regions and countries, contributes to the diffusion and expansion of knowledge.

For these reasons, youth employment and productivity growth create a virtuous circle. When firms become more productive they are more likely to employ young people. And when young people have such opportunities, they can capitalise on their skills, adding to productivity growth, which among other benefits for society will lead to higher wages.

Youth unemployment breaks this virtuous circle: it is a drag on innovation and impedes knowledge diffusion by decreasing mobility.

Additionally, unemployment prevents experienced workers and young workers from interacting. The experienced ones don't benefit from insights and knowledge of the young. And they, in turn, don't gain from the know-how of more experienced workers.

### **The role of policies**

As we have seen, there are cyclical and structural reasons for the high rates of youth unemployment.

Demand-side policies, such as fiscal and monetary policy, can help to address cyclical fluctuations. Our monetary policy measures, aimed at maintaining price stability, are supporting domestic demand and thus the recovery in employment, from which also younger generations of Europeans are benefiting.

Furthermore, we should not forget that the crisis was a financial crisis, and therefore financial policies are also essential. It is important to further improve the resilience of the financial system by strengthening sectoral balance sheets, and having an appropriate financial regulatory and supervisory framework, and a robust macroprudential policy framework.<sup>10</sup>

But the rise in youth unemployment has also deeply rooted structural reasons.

The persistence and heterogeneity of youth unemployment rates across the euro area countries even before the crisis, as well as the diverse developments during the crisis, indicate that there is need for specific policies to improve education and labour market functioning in some countries.

Higher levels of education are positively correlated with both greater labour market participation and lower unemployment. The risk of losing a job is significantly higher for people with low educational attainment. And this group was severely hit by the crisis, with their unemployment rate increasing from about 11% in 2008 to 21% in 2013 in the euro area. The pattern is similar for young workers. For example, in Ireland the unemployment rate of young people with an educational attainment below lower secondary education was 27.5% in 2016, while for young people with tertiary education it was about 11%.

Acquiring a good skill set at school and university is therefore essential for a young person to find work.

However, skill mismatch indicators – which quantify the difference between skills wanted and

skills offered – still remain at elevated levels, with only a slight moderation compared with the record levels at the height of the financial crisis.<sup>11</sup>

But skill mismatches are not just a consequence of the crisis. In fact, they started to increase before the crisis because of structural changes related to digitalisation and globalisation. The skill mismatch index for the euro area labour market in 2007 was almost twice as high as it was in 2004.<sup>12</sup>

There is also large heterogeneity across the euro area countries. The OECD's Survey of Adult Skills shows that while young adults in, for instance, Finland and the Netherlands perform well in problem-solving in technology-rich environments, in other countries they score significantly lower and youth unemployment is correspondingly higher.<sup>13</sup> Furthermore, the correlation between PISA scores and youth unemployment in the euro area is strong and negative.<sup>14</sup>

The percentage of the working age population that has completed upper secondary or tertiary education ranges widely in the euro area – from a high of more than 90% in some countries to a low of around 40% in others. The need for improving skills has also been confirmed by the results of an ad hoc ECB survey of leading euro area businesses. The survey revealed that over 90% of businesses strongly supported reforms geared to enhancing the quality of education and training.<sup>15</sup> These factors were deemed particularly relevant in the light of shifts towards knowledge-intensive skill sets, digitalisation and given long-standing structural deficits in engineering skills.

Other non-tertiary education, such as the dual training and apprenticeship systems which we have in some euro area countries, has also been shown as helping to facilitate the transition from school to work. In particular, Austria and Germany have been successful in keeping youth unemployment low mostly because of their efficient use of vocational training and programmes targeted at disadvantaged youth.<sup>16</sup>

The employment prospects of the young also depend on the existence of efficient labour market institutions.

The vocational education system, together with more flexible wage setting, and stronger public support for helping the unemployed to seek and find jobs, as well as lower labour market segmentation explain in part why the youth unemployment rate is lower in Germany than in France.<sup>17</sup> Furthermore, labour market rigidities decrease both inflows into and outflows from employment, and tend to reduce hiring of the young, especially during recessions.

In dual labour markets, it is typically young workers that have temporary contracts and that shoulder much of the burden of adjustment.

Segmentation of the labour market and poor vocational training are also among the main reasons for the persistent high level of youth unemployment in several countries that have been hit severely by the recession such as Greece, Spain, Italy and Portugal.<sup>18</sup>

## **The role of Europe**

Europe's role in addressing the problem is primarily defined by its Single Market that has removed many barriers to the free movement of goods, people, services and capital. Indeed, the Single Market fosters competition among firms. In the long run, firms' competitiveness is not only determined by pricing, but also by other product features that meet customer demands. Knowledge and innovation of products and processes are therefore essential.

The Single Market requires firms to be more productive, so that they activate the virtuous circle between productivity growth and youth employment that I described earlier. And indeed, the

countries that have a high degree of openness and have benefited most from the Single Market, are also those with lower youth unemployment<sup>19</sup>.

Therefore, also to support youth employment and incomes, the first and most important policy decision at European level is to complete the Single Market in all its dimensions. But to fully reap the benefits of openness, the Single Market needs to be embedded in supportive policies and institutions. Competition not only creates opportunities for some firms to expand, it also drives others out of business and displaces workers in entire industries. It is therefore essential that those workers are supported when resources are channelled towards more productive firms or sectors. Protecting people, rather than jobs, means ensuring that they have or will acquire the necessary skills to be employed in other more productive parts of the economy.

Today much of this support falls under the competence of Member States, but also the EU can build on existing instruments, such as the European Globalisation Adjustment Fund and the European Social Fund.<sup>20</sup>

There is a second way in which European integration can support youth employment: by fostering the exchange of ideas and knowledge as researchers, students, and technologies move across Europe.<sup>21</sup>

I am sure that many of the students here have been on an Erasmus exchange, or have come from other European countries to study here. There is clearly a European dimension to education. And Europe can contribute by investing in such exchanges as well as more broadly in the advancement of science.

The new Erasmus+, which now offers more opportunities for learning and training, is thus a welcome development. And the Bologna Process makes it easier for young people to work in another EU country by facilitating the recognition of qualifications across borders.

Moreover, the Youth Guarantee programme provides welcome support to the commitment by Member States to ensure that young Europeans under the age of 25 receive a good quality offer of employment, training or continued education.

Labour mobility is often, when undesired, the result of poor cyclical and structural labour market conditions. It is those conditions that should be addressed in the first place. The completion of the Single Market, the continuing progress in European integration and the deepening of our Economic and Monetary Union, will further expand the opportunities for young people beyond borders, and job matching possibilities. Labour mobility across countries and sectors is bound to increase. This will require adequate supranational policies.

## **Conclusion**

Let me conclude.

In some countries, and Ireland is one of them, some progress in reducing youth unemployment has been achieved. More generally, the strengthening of the recovery in the euro area will continue to reduce its extent. But to address structural causes of youth unemployment, a uniform degree of protection among workers, flexible labour arrangements, effective vocational training programmes, high degree of trade openness, and support to reduce the social cost of mobility are all necessary conditions.

I have highlighted the economic reasons that make addressing youth unemployment an invaluable undertaking. But there is a more fundamental reason to continue addressing this challenge with determination and as a priority. We have seen how in several countries the weight of the crisis has fallen disproportionately on the young people, leaving a legacy of failed hopes, anger and ultimately mistrust in the values of our society and in the identity of our democracy.



Some say that a more equitable distribution of income and wealth is the answer and that it would bring those who have lost out from globalisation back into our compact. But that cannot be enough for the young people who are the future of our democracies. They do not want to live on subsidies. They want to work and expand their lifetime opportunities. Today after the crisis, governments know how to respond to their quest, and how to create an environment where their hopes have a chance. They should do so: for the future of their countries' youth and of their democracy.

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- <sup>1</sup> See Bell, D. and D.G. Blanchflower (2011): *Young People and the Great Recession*.
  - <sup>2</sup> Based on the latest Eurostat data.
  - <sup>3</sup> Another alternative measure of unemployment for Ireland has been recently discussed by Byrne, S. and T. Conefrey (2017): "A Non-Employment Index for Ireland", *Economic Letter Series*, Vol 2017, No. 9, Central Bank of Ireland.
  - <sup>4</sup> For example: Gregg P. and E. Tominey (2005) show that an early period of unemployment can lower wages by up to 20% at the age of 42; See Gregg P. and E. Tominey (2005), "The wage scar from male youth unemployment". *Labour Economics* 12 (4): 487–509.
  - <sup>5</sup> Research shows that a person exposed to a recession between the ages of 18–25 years has little confidence in public institutions. See Giuliano P. and A. Spilimbergo (2009): "Growing Up in a Recession: Beliefs and the Macroeconomy", NBER Working Paper No. 15321, September.
  - <sup>6</sup> See Coad A, S.-O. Daunfeldt, D. Johansson and K. Wennberg (2014). "Whom do high-growth firms hire?" *Industrial and Corporate Change*, Volume 23 (1): 293–327.
  - <sup>7</sup> See Franses, P. H. (2014), "When Did Nobel Prize Laureates in Literature Make Their Best Work?" *Creativity Research Journal*, 26(3), 372–374; Franses, P. H. (2016), "When Did Classic Composers Make Their Best Work?", *Creativity Research Journal*, 28(2), 219–221.
  - <sup>8</sup> See Albert C., C. García-Serrano and V. Hernanz (2005) and P. López-García and J.M. Montero (2011), and Bentolila, S. and Dolado, J. and Jimeno, J., (2012), "Reforming an insider-outsider labor market: the Spanish experience," *IZA Journal of European Labor Studies*, 1(1): 1-29.
  - <sup>9</sup> See Bosler C. and N. Petrosky-Nadeau, (2016), "Job-to-Job Transitions in an Evolving Labor Market", *FRBSF Economic Letter*, November 14.
  - <sup>10</sup> See speech by Lane, P. (2017), *Macro-Financial Risk Management*, Dublin, September.
  - <sup>11</sup> This is likely to partly reflect the large job losses of lower-skilled employees seen over the crisis as a consequence of the longer-term secular trend towards upskilling which accelerated during the crisis.
  - <sup>12</sup> ECB staff calculations based on Eurostat data. Skill mismatch indicator is computed on the basis of the summation of differences in the skill shares of the unemployed and employed across three skill groups (less than primary, primary and lower secondary education; upper secondary and post-secondary non-tertiary education; and tertiary education).
  - <sup>13</sup> OECD (2015), "Adults, Computers and Problem Solving: What's the Problem?", OECD Publishing, Paris.
  - <sup>14</sup> Using data on the 2015 PISA scores in mathematics from the OECD and 2015 youth unemployment data calculated by Eurostat.
  - <sup>15</sup> ECB Economic Bulletin, Issue 6/2017.
  - <sup>16</sup> *No Country for Young People? Youth Labour Market Problems in Europe*, edited by Juan J. Dolado, a VoxEU.org eBook, 2015.
  - <sup>17</sup> See Cahuc, P., S. Carcillo, U. Rinne and K. F. Zimmermann (2013), "Youth Unemployment in Old Europe: The Polar Cases of France and Germany". *IZA Journal of European Labor Studies*, 2, pp. 1-23.
  - <sup>18</sup> *No Country for Young People? Youth Labour Market Problems in Europe*, edited by Juan J. Dolado, a VoxEU.org

eBook, 2015.

- <sup>19</sup> Eurostat data for 2016 shows that the openness of EU (and euro area) economies to intra-EU (and intra-euro area) trade, measured as the ratio of the aggregate value of goods and services imports from and exports to the EU (and the euro area) to GDP, is negatively correlated with youth unemployment.
- <sup>20</sup> See Cernat L. and F. Mustilli (2017), “Trade and Labour Adjustment in Europe: What Role for the European Globalization Adjustment Fund?”, *DG Trade Chief Economist Note*, European Commission, Issue 2, May 2017.
- <sup>21</sup> See Pelkmans, J. (2016), “What strategy for a genuine single market?”, CEPS Special Report No. 126 (January).