Ref. Ares(2016)2491733 - 30/05/2016

Youth Unemployment and the Legitimacy of European Governance

Contents

Social Europe, the aftermath of the Crisis and the Fight against youth unemployment

The social impact of the crisis

It is important to see the link between adverse social outcomes and the limitations of the macroeconomic framework (Vaughan-Whitehead ed. 2015, Dolvik and Martin eds. 2015). Thanks to the imperfect nature of EMU, adjustment to economic shocks tends to occur not through expansionary fiscal or monetary policies that would temporarily drive up inflation and reduce unemployment, but through internal devaluations in deficit countries, which lead to low inflation or outright deflation and are accompanied by high levels of unemployment. Yet wage- inflationary pressures are much less likely nowadays than in the 1970s or 1980s because of the changes undergone by weakened trade unions, so that collective bargaining has become more decentralised and is easier to opt out of.

In many EU countries, Spain and Germany for instance, nominal unit labour costs have been rising less than overall prices, thanks to deliberate wage constraint or inefficient product markets. The result has been a further compression of aggregate demand and an even more pronounced impact on unemployment. At the time of the crisis, the EMU re-divided Europe in terms of economic and social polarisation between South and North. In the absence of well-functioning financial markets, the Eurozone became a club of creditors and debtors, which significantly enhanced the dominance of core countries, and especially those with an AAA rate, over the deficit countries. Arguably, divergences between the core and the periphery of the Eurozone (or North-South imbalances) are a lot more dangerous for the sustainability of the EMU and the stability of the EU than East-West imbalances. The latter are linked to the wide income gap between old and new member states, which despite the crisis, continued to diminish in the last five years.

Why did Europe become so divided in terms of economic and social outcomes? A key factor has been the design of the EMU, with monetary policy being centralised at the European Central Bank, but fiscal and structural policies being predominantly under the responsibility of national governments, without there being any eurozone budget in place. This means that instruments that were historically used to limit the social impact of crises were not available any more, while there has been nothing newly introduced to replace them. This also means that the Europe 2020 targets cannot be expected to be achieved, not even with big delay, without further monetary reform.

The social crisis of the periphery did not result from the insufficient number of social policy recommendations. Europe's jobs crisis is linked to its weak and imbalanced macroeconomic performance, and notably to less effective fiscal and monetary responses than in the U.S. and Japan to the financial and economic crisis. The EU's labour markets are being adversely affected by a persistent gap in most member states between effective aggregate demand and potential output, and this combines with high unemployment, the large overhang of private debt, low inflation and nominal interest rates that are close to their lower limit.

The sovereign debt crisis since 2010 and the fiscal consolidation strategies implemented in response to it have substantially weakened the welfare state in more peripheral regions of the Eurozone. In particular, they have weakened the effectiveness of so-called automatic fiscal stabilisers at the national level, which means the ability of a state to immediately act in a countercyclical way as tax revenues drop and social expenditure increases.

Unemployment increased to 11 percent in the EU and 12 per cent in the euro area in 2013, but it became twice as high on the Eurozone periphery. Unemployment amounted to a quarter of the workforce in both Spain and Greece in 2013, and youth unemployment rates peaked above 50 per cent in both. In these two countries, income inequality (as measured by the GINI index) was already higher than the EU average before the crisis, and it continued to grow further in the crisis years.

In adjusting countries, where economic growth was negative and unemployment was on the rise in 2011-13, poverty has also risen significantly. Demand for the services of food banks has grown and many young people lacking opportunities choose to emigrate, often to other continents, which by definition results in a loss of human capital for Europe as a whole.

Upgrading EU employment and social policy

In April 2012, the Commission adopted an Employment Package for a job-rich recovery that sought to identify ways of boosting employment in the difficult new circumstances. For jobs, this was the most comprehensive policy document to be agreed on since the launch of the Europe 2020 strategy, when the EU was facing an urgent jobs crisis, with the longer-term prospect of rising structural unemployment, a steady loss of skilled labour and the further erosion of Europe's growth potential. The Employment Package emphasised that both the preservation and the creation of jobs had to be pursued as direct and immediate goals, and as part of a wider effort to combat Europe's economic crisis.

The Employment Package was innovative in many respects, but mainly because of its emphasis on stimulating demand for labour. Based on feedback from both labour and business representatives at a major conference on flexicurity in November 2011, this concept became sidelined in the Employment Package. Instead, we spoke about dynamic and inclusive labour markets, a concept which immediately turned out to be helpful for the Italian reform agenda championed by Elsa Fornero, and other efforts at that time elsewhere.

The key problem was how to boost job creation and demand for labour in a low-growth environment. The Employment Package drew some inspiration from the U.S. recovery. To strengthen demand for labour in Europe, the Package emphasised the need to reduce the tax wedge on low-paid workers, to deploy targeted hiring subsidies and to boost entrepreneurship, including social entrepreneurship.

The OECD advocated much the same approach at the G20 Summit in 2013, and then in September 2014 a Eurogroup meeting of eurozone finance ministers came out strongly in favour of reducing the tax wedge on low-paid labour. They called for it to be a clear policy priority on the structural reform agenda. It's also generally recognised that maintaining existing jobs through better adaptability and through internal flexibility within companies, based on social dialogue, is equally important.

Boosting demand for labour also has a strong sectoral dimension. That's why the Employment Package outlined ways to tap the jobs potential of sectors that are set to grow because of long- term structural trends, particularly the green economy, ICT and healthcare services. We later followed up on this sectoral dimension with such initiatives as the Grand Coalition for Digital Jobs and the Green Employment Initiative.

The second main strand of the Employment Package consisted of structural measures to make Europe's labour market more dynamic and inclusive. The three main elements of this have been balanced labour market reforms, enhanced investment in skills and better conditions for labour mobility in what should be a genuine European labour market.

Balanced structural labour market reforms include the promotion of internal flexibility, a reduction of labour market segmentation, investment in a greater capacity of public employment services (including cooperation among them), and closer links between unemployment benefits and the mechanisms designed to encourage people back into work.

Stressing the need for more inclusive labour markets is important because it means the integration into the active workforce of people who would otherwise be judged as less productive. These are the very young and less skilled at the beginning of their careers, older workers, and especially those who have been unemployed, women, especially those with children, and people with disabilities. Belonging to an ethnic minority like the Roma can also mean systematic disadvantage in the labour market as well as in society in general.

The Commission advocated and supported the creation of well-designed and powerful national strategies to introduce a more inclusive model and achieve higher employment. Better organised labour mobility as another part of the new approach. The vision of a genuinely European labour market highlighted the potential inherent in cross-border mobility, and it also confronts two common fallacies. One is that immigration is a cause of unemployment, and the other that labour mobility has a dominant role in addressing imbalances within the EU, and the eurozone especially.

The 2012 Employment Package was the first EU Communication to call for a decent minimum wage in all EU member states, and it also called for the first tripartite exchange of views on wage developments to involve EU as well as national social partners. It emphasised the importance of social dialogue in more general terms too as part of the EU's pursuit of a job-rich recovery. It outlined ways to involve the social partners in European economic governance.

The policy agenda articulated in the Employment Package has since then been reflected in the recommendations issued in the consecutive European Semesters. It was followed-up on by the Youth Employment Package (2012 December) and the Social Investment Package (2013 February). Other follow-up actions include an EU quality framework for anticipating change and restructuring that is closely co-ordinated with the Commission's industrial policy initiatives and the re-launching of the European Globalisation Adjustment Fund in the new EU budget.

A further important document was produced in October 2013 for strengthening the social dimension of the EMU. This communication introduced a scoreboard of five key employment and social indicators, it demonstrated that overall unemployment and youth unemployment and inactivity, along with income inequality and poverty, all showed significant and dangerous divergence during the crisis, especially inside the euro area.

This cluster of policy documents helped developing a new focus for the EU employment and social strategies. These documents were also created in order to feed into the European Semester, and most concretely the Country Specific Recommendations. Vanheuverzwijn (2014) documents the changing balance of the European Semester towards a greater weight of social policy recommendations.

Social dimension and legitimacy

Legitimacy partly comes from the process and partly from the outcomes (Schmidt 2013). It is about institutions, but also about politics and values. The lack of economic opportunities, particularly for the young and long-term unemployed, and rising inequalities undermine social cohesion and trust.

National governments and the EU as a whole are losing legitimacy in the eyes of many workers and other citizens by failing to deliver what is expected from them, i.e. broadly shared prosperity and equal opportunity to improve one's situation. This may even translate into political instability at the national level, but also at EU level, where economic and social divergences can generate disunity.

Proper functioning and public acceptance of the EMU can only be guaranteed if steps to strengthen discipline, solidarity and legitimacy are taken simultaneously, and the EU restores commitment to cohesion and convergence (Offe 2014). Better governance and a stronger coordination of social policies is possible, but insufficient to restore the potential of convergence. The social dimension of the EMU is crucial for the legitimacy of the European project but also – given the deep integration of our policies – for the legitimacy of national policies.

However, it cannot be pursued in the same way as the social dimension of the single market. The latter is mainly a matter of legislation, while strengthening the social dimension of the EMU is fundamentally a matter of financial and monetary instruments. The Europe 2020 Strategy was launched with a strong social dimension. However, the EU's efforts to develop the demand side of labour market policy have been constrained. They are to be found in the area of macroeconomic policy making: the disinflationary bias in the eurozone's monetary policy, and its bias towards internal devaluation.

If the Member States agree to pool more financial, budget and economic sovereignty, this inevitably calls for a clear framework for social coordination and convergence. Otherwise, it will only lead to more fierce competition between the Member States, lowering of social standards and the jeopardising of the social model.

This social crisis cannot be considered as a matter of subsidiarity. Social policy alone, even if national welfare systems are reformed, cannot handle the social consequences of the Eurozone crisis. Given the constraints which membership in a monetary union implies, it is fundamental to re-create possibilities of macroeconomic adjustment inside the euro zone whereby aggregate demand and economic growth can be maintained.

The social dimension of the EMU is crucial for the legitimacy of the European project but also –

given the deepening economic governance - for the legitimacy of Member States policies. But, it cannot be pursued in the same way as the social dimension of the single market. The latter is mainly a question of legislation, while strengthening the social dimension of the EMU is fundamentally a question of financial and monetary instruments. Hence South-North imbalances necessitate a broader and more substantial reconstruction of the EMU – or an “EMU 2.0”.

Overview of the Social dimension of EU integration components

	Single market	EMU 1.0	“EMU 2.0”
Solidarity axis	High income – low	Surplus – deficit	Surplus – deficit
Standard policy	Social legislation Cohesion budget	--	Fiscal risk sharing
Crisis response	--	Internal devaluation Social retrenchment in	Conditional support for adjustment

Fighting Youth Unemployment and Inactivity

Concept and first assessment

During the Eurozone recession, youth unemployment became a major concern for policy makers and also appeared as a central theme in EU economic governance. When youth unemployment peaked in the EU in 2013, we counted about 5.5 million unemployed under the age of 25. This meant that one in five unemployed person in the EU was less than 25 years of age. Many young people experienced long-term unemployment, and the number of 15-29 year olds neither in employment, education or training (NEET) was nearly 14 million for several years. In 2013, 17 Member States received country-specific recommendations on the Youth Guarantee or wider youth employment-related issues under the European Semester process. For many of them, the recommendations were repeated one year later again.

Since then, a mild and uneven economic recovery has helped to reduce youth unemployment in the EU by about 1 million, to 4.5 million. But even if it had been “just” 4.5 million at the peak, it would have been enough for demanding EU-level action. In fact, the Commission launched the discussion among Member States and stakeholders well before the Eurozone recession (with the Agenda for New Skills and Jobs, November 2010). By 2012, high youth unemployment came to be understood as truly common concern. One could even speculate that EU leaders sought common action on youth employment to compensate for the bad conscience that European macroeconomic policy coordination had contractionary rather than growth-friendly results in those years.

An EU level initiative had to be developed with awareness of employment policy being a shared responsibility between the EU and its member states. Nevertheless, the Commission arrived to this point in a gradual fashion: first including in the Europe 2020 Strategy a youth focused flagship initiative ("Youth on the Move"), and adopting a Youth Opportunities Initiative in 2011 in order to mobilise available resources in support of unemployed young people in 8 most affected countries (Greece, Spain, Italy, Portugal, Latvia, Lithuania, Slovakia and Ireland).

To what extent the recent improvement in youth employment can be attributed to the EU Youth Guarantee (YG) initiative can be discussed. One can argue that this is not exactly the area of the labour market where job creation picks up very quickly after a recession. Very often more experienced workers get new employment first, often in atypical jobs or at lower wages, and only then opportunities appear for youngsters just leaving school and lacking work experience[i]. Youth can still be "last in, first out" in more segmented labour markets, and this remains a feature of many Southern European economies, despite recent reforms.

Besides assessing overall statistics, it is important to follow the actual implementation of YG schemes and pilot projects. At the request of the European Parliament, the European Commission[ii] directly managed 18 small scale pilot projects in 7 Member States (Ireland, Italy, Lithuania, Poland, Romania, Spain, UK) and published its findings in August 2015. Simultaneously, the ILO[iii] conducted a very thorough assessment of the European Youth Guarantee experience. The European Economic and Social Committee[iv] as well as the European Policy Centre[v] also took a closer look at the actual impact.

These studies independently conclude that the Youth Guarantee provides a very good framework for seriously addressing the youth employment challenge, but that achieving the desired results requires consistent implementation over several years, backed up by adequate financial and administrative resources. The analyses also confirm several Achilles' heels anticipated already during the Youth Guarantee's launch, for example the need for adequate capacity of public employment services and the importance of actively trying to reach out to those hardest-to-help.

Common misconceptions about the Youth Guarantee

Independent studies are also useful to clarify some misconceptions that often distort the discussion around the Youth Guarantee.

1. Evaluation cannot purely focus on the youth unemployment rate, even if it is a crucial indicator in this area. The aim of the YG is not simply to bring down registered youth unemployment, but also to reduce the number of those neither in employment, nor in

education or in training (NEETs). The paradoxical effect of NEETs reduction is that these inactive young people first have to register as unemployed, and thus the youth unemployment rate may temporarily increase.

2. In debates on the Youth Guarantee, it is often mentioned (by supporters and detractors alike) that the money allocated by the EU for its implementation is "not enough". This judgment is based on an excessive focus on the € 3 billion Youth Employment Initiative (YEI), which was invented in the endgame of the 2014-20 EU budget negotiations as a two-year top-up fund to boost the fiscal capacity of the most affected regions where the youth unemployment rate was much higher than the EU average in 2012. However, the YEI has always been the smallest account in a bigger envelope, which also consists resources of the European Social Fund and of national budgets. That the EU should fully fund the Youth Guarantee, without significant contributions from the member states, was never considered and it would have been probably wrong. Pure EU funding would mean that national administrations have less skin in the game and fewer incentives to use the money effectively, for real improvement of the existing labour market structures. That said, it is right to ask whether all Member States have adequate resources available to finance continued implementation of the Youth Guarantee even now when the €3 billion Youth Employment Initiative is no longer there.
3. Critics sometime stress that youth unemployment is just a symptom, while austerity is the real problem, and there is of course an element of truth in this. However, the Youth Guarantee was never meant to be a substitute for good macroeconomic policy and economic growth. It has always been clear that if macroeconomic policy fails to provide a stimulus at a time of recession, deflation and stagnation, the Youth Guarantee cannot achieve a miracle. In a weak macroeconomic environment, those going through a subsidized period of employment or training can end up again in need of assistance, maybe several times. However, even in such cases participation in the YG scheme has to be seen as beneficial, since the chances of success in future job search are much higher with additional training or subsidized work experience as opposed to prolonged unemployment or inactivity.

Beyond the above simplifications, Youth Guarantee skeptics often represent some kind of reductionism. Some tend to reduce the explanation of youth unemployment to the lack of skills, or motivation/activation, or entrepreneurship, or geographical mobility, others see it just as a result of low demand for labour. Too much regulatory burden on business is sometimes mentioned too, leading to claims that deregulation ("cutting red tape") is sufficient to allow companies to hire more.

In reality, large youth unemployment and inactivity are a product of a combination of all these, and the actual weight of the various factors can only be determined in the local context. No one- size-fits-all policy could be worked out to treat the problem, but if local stakeholders cooperate well in analysis, policy design and implementation, the chance of success can be very high, just like in Austria or Finland, the two countries from where the Youth Guarantee originates.

Between structural reform and macroeconomic stimulus

The Commission's Youth Guarantee initiative was born at the time of the Eurozone crisis. However, it would be wrong to assume that it was presented as a 'fig leaf' instead of efforts to resolve the Eurozone crisis. Exactly at the same time when the Commission proposed establishing the Youth Guarantee, it also put forward a Blueprint[vi] for the reconstruction of the Economic and Monetary Union, which was the starting point for establishing the Banking Union and launching a debate on many other instruments.

Without being explicitly part of the EMU reform agenda, the Youth Guarantee has helped to rethink prevailing supply-side structural reform prescriptions. It helped to open up a debate on what structural reforms are really useful and in what timeframe they can have an impact. The Youth Guarantee also helped to shift attention to the demand side of the economy. While some critics[vii] opined that the YG would just be old supply-side wine in new bottles, the Commission consistently encouraged Member States to use demand-side interventions (e.g. hiring subsidies or traineeship grants) as part of YG implementation.

By allowing governments to decide on the precise types of intervention, the Youth Guarantee has a potentially counter-cyclical character. In boom times it can shift resources towards training and other supply-side actions, while in depression demand-side interventions can be stepped up, notably various forms of work subsidies.

The need to allow for both supply and demand side action was never questioned at the time of YG preparation. At the time of debates with Council and the European and national parliaments (2012-3), discussions revolved around two main components of the YG: the definition of the age group and the deadline for the offer. As compared to the Commission proposal for 25 years as the upper boundary, some wanted to see 30 years. The Commission opposed this, driven by the awareness of limited funding, but also to avoid diluting the primary purpose of the YG, which is improving school-to-work transition. What concerns the 4-month deadline for a good quality offer, some advocated 6 months, and this minority mainly came from countries generally skeptical about active labour market policies (ALMP) and/or lacking the necessary institutions and instruments in place[viii].

Though we would all wish to see a faster fall of youth unemployment, and complaints about insufficient implementation of the YG are common, very few today question the concept that was adopted in 2013. Quite the contrary: the YG served as a model and inspiration for tackling long-term unemployment when the Commission put forward a strategy on the latter in 2015. There is indeed a close connection here, since the Youth Guarantee was not meant to be a policy to eliminate all unemployment under 25, but to eliminate too long unemployment spells, most damaging for the young generation.

A common, and fair remark in today's discussions on the YG is that greater emphasis is needed on "quality" of help provided, based on better definitions and practical mechanisms of quality control. Some quality aspects are addressed in the EU Quality Framework for Traineeships agreed in 2014, and there is certainly room for doing more, inside and outside the context of the Youth Guarantee.

The EU Youth Guarantee initiative never offered a magic wand to eliminate youth unemployment immediately, and it was not meant as a substitute either for good macroeconomic policies or for EMU reform. True, it gained the necessary political attention and support because it was part of the EU's response to the Eurozone crisis. But its main relevance is as longer-term structural reform improving the school-to-work transition process and repairing the pre-crisis models of labour markets and education.

European action for youth employment remains indispensable today. In our view, it should focus first and foremost at consistent and thorough implementation of the Youth Guarantee – a policy agreed at the peak of the crisis to improve the structural conditions of labour markets working for young people and to boost support available for them, in the interest of cohesion as well as productivity in our societies.

The Youth Guarantee is an EU-wide framework helping to transfer the best existing practices of school-to-work transition to countries that fail their young generations. It is a complex set of measures and therefore it has been often characterized as a structural reform. It should be evaluated in these terms, and once fully implemented, it should remain a central component of a modern European Social Model.